INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

BUILDING AUSTRALIA TOGETHER

SUBMISSION TO THE SENATE SELECT COMMITTEE ON ELECTRICITY PRICES

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ABOUT INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

Infrastructure Partnerships Australia (IPA) is the nation's peak infrastructure body. Our mission is to advocate the best solutions to Australia's infrastructure challenges, equipping the nation with the assets and services we need to secure enduring and strong economic growth and meet national social objectives.

Infrastructure is about more than balance sheets and building sites. Infrastructure is the key to how Australia does business, how we meet the needs of a prosperous economy and growing population and how we sustain a cohesive and inclusive society.

IPA seeks to ensure governments have the maximum choice of options to procure key infrastructure. We believe that the use of public or private finance should be assessed on a case-by-case basis. IPA also recognises the enhanced innovation and cost discipline that private sector project management and finance can deliver, especially with large and complex projects.

Our membership is comprised of the most senior industry leaders across the spectrum of the infrastructure sector, including financiers, constructors, operators and advisors. Importantly, a significant portion of our Membership is comprised of government agencies.

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EXECUTIVE SUMMARY

Inefficient escalations in the cost of electricity are directly impacting Australian households and businesses, and are serving as a handbrake on national productivity.

Ultimately, meaningful long-run solutions lie with the completion of structural reform across the National Electricity Market (NEM) aimed at fostering competitive retail and generation sectors, as well as optimally efficient network operation and investment.

Achieving an optimally competitive, efficient electricity market will require the well-structured privatisation of all remaining publicly-owned electricity businesses to ensure that the right signals are sent for efficient investment in new capacity. Like any sector of the economy, a competitive electricity market will achieve efficiency in the use of scarce resources, as companies compete for customers on price and diverse service offerings, and innovate to keep costs low.

Yet in Queensland, Western Australia and Tasmania public-ownership in the retail and generation sectors persists, serving to limit competition in these states and, in the case of Queensland and Tasmania, across the broader NEM.

Continued public ownership is also impacting the non-contestable, natural monopoly elements of the electricity supply chain. In particular, continued public-ownership of electricity transmission and distribution businesses is leading to higher operating costs and inefficient capital investment, which is ultimately driving-up retail electricity prices in those states.

The natural market disciplines that apply to private companies – such as the threat of takeover, the risk of bankruptcy and monitoring mechanisms associated with listing on share markets – do not apply to government-owned corporations. In addition, network operation and capital spending is driven by factors other than economic requirements or transparent community service obligations.

The experience of private network ownership in Victoria is a compelling one. According to a 2011 Ernst & Young study, network costs in Victoria decreased by 9 per cent in real terms (on a per customer basis) between 1996 and 2010 (Ernst & Young, 2011). Over the same period, per customer network costs in New South Wales and Queensland increased by 65 per cent and 105 per cent respectively.

Over the next five years, New South Wales and Queensland network businesses are expected to spend up to three times the level of capital expenditure per customer than their Victorian counterparts; suggesting that consumers in these states will continue to shoulder the costs of higher operating costs and inefficient investment (iGrid, 2011).

Alongside the establishment of wholly private electricity market, permanent solutions lie with the removal of retail price regulation; which is a critical enabler of an efficient market price.

In a competitive retail market price regulation has an adverse impact, imposing distortions on the effective functioning of the market to the detriment of consumers. Regulation is also costly in terms of administration and compliance, further adversely impacting the objective of a truly efficient price.

IPA recognises that achieving substantive energy market reform is not easy, as the divisive policy debate that has surrounded energy reform in some states will attest. However, the privatisation and deregulation of Australia's electricity markets is critical to:

1. Easing cost of living pressures on Australia's households;
2. Increasing the relative competitiveness of Australia's business sector;
3. Substantially repairing the fiscal capacities of the unreformed states, unlocking substantial budget headroom to fund new productivity-boosting infrastructure;
4. Transferring substantial supply risk away from taxpayers; and
5. Putting in place the permanent market-settings to drive down prices, in-turn breaking governments' dependence on short-term, blunt tool approaches to retail price setting.

Australia's governments are elected to make the best decisions in the interests of the taxpayers, consumers and the broader economy – and those decisions are not always the easy option.

Australia has come a long way from the days of single, vertically integrated utilities under full public ownership, but much remains to be done.

The Commonwealth Parliament, and executive, have a critical leadership role to play in advancing the case for energy reform in states where it has stalled. To demonstrate leadership in this regard, the Commonwealth Government should begin negotiations with the New South Wales and Victorian governments for the full sale of Snowy Hydro.

IPA hopes that this Submission is of assistance to the Senate Select Committee; and that the Committee's deliberations help to create an impetus toward fundamental reform in the interests of both energy consumers and taxpayers.

KEY POINTS

1. **The rising cost of electricity is directly and negatively impacting Australia's households and businesses.**

2. **As a key input cost for the production of goods and services, inefficient electricity pricing is also a key reason for Australia's declining productivity; and is eroding the abilities of Australia's business sector to compete in a global market.**

3. **The states that have reformed the ownership of retail, generation and transmission and distribution have enjoyed measurable and sustained benefits over states who have failed to reform their electricity sectors – or who have only achieved partial reform.**

4. **The inefficient escalations in electricity prices are best addressed through the completion of reforms across the National Electricity Market (NEM). Steps to completion must include:**
    - **The sale of all remaining publicly-owned retail, generation and network businesses – removing inefficiencies and disincentives for private investment.**
    - **The timely removal of retail price regulation – to remove price distortions and to pave the way for the establishment of an efficient market price.**

5. **While Western Australia and the Northern Territory are not part of the NEM, they should simultaneously progress structural reform of their retail and generation sectors to promote a competitive electricity market.**
    - **These reforms should be undertaken with a view toward the full privatisation of all publicly held assets, within five years.**

6. **In advance of reforms toward an efficient market, policymakers must resist the temptation to artificially depress retail prices:**
    - **Regulatory limits which depress retail prices below the efficient cost of supply ultimately hurt households and businesses, because there will be an inevitable 'catch up'.**
    - **Artificial price limits that are below the cost of supply also represent a substantial taxpayer risk, reducing the incentives for private investment and imposing substantial costs on taxpayers.**
    - **Rather, governments should be pursuing meaningful reforms aimed at increasing competition and establishing an efficient market price.**

7. **The Commonwealth Parliament, and executive, have a critical leadership role to play in advancing the case for reform – including privatisation – in states where it has stalled.**

8. **To demonstrate leadership in establishing a wholly private market, the Commonwealth Government should begin negotiations with the New South Wales and Victorian governments for the full sale of Snowy Hydro.**

9. **The Commonwealth Government should support a market-based approach to Demand Side Participation (DSP); recognising that consumers are ultimately best placed to determine the form of demand management of most value to them.**

1 INTRODUCTION

Australia's public policy debate is correctly focussed on two substantial themes: the cost of living afflicting households; and the accelerating fall in Australia's productivity and global competitiveness that is constraining the nation's business sector and broader economy.

The Senate Select Committee inquiry therefore presents a timely and important opportunity to enquire and resolve the best options to deliver meaningful and sustained solutions to electricity price rises, a key component of both the cost of living and productivity challenges facing the country.

The experience of market-based reform to the Victorian and South Australian electricity sectors in the 1990s and early 2000s provide an excellent and long-term case study of the positive impacts that well-considered reform provides for energy consumers and taxpayers.

From the mid-1980s, Australia pursued an accelerating process which saw the national economy exposed to global competition. The staged reduction of tariff protections, the deregulation of the financial sector and other complementary reforms also exposed the substantial inefficiency in the nation's infrastructure services, including telecommunications, electricity, aviation and freight transport.

Australia's governments responded with rational, market-based reforms that sought to fundamentally alter the structure, ownership and functionality of infrastructure services markets, including electricity.

The 1995 National Competition Policy (NCP) and related reforms provided a national context and framework for energy reform. Under the NCP, states agreed to restructure their electricity sectors, apply competitive neutrality and grant third-party access.

These reforms also paved the way for the creation of a National Electricity Market (NEM), with associated national institutions to oversee its rules and management.

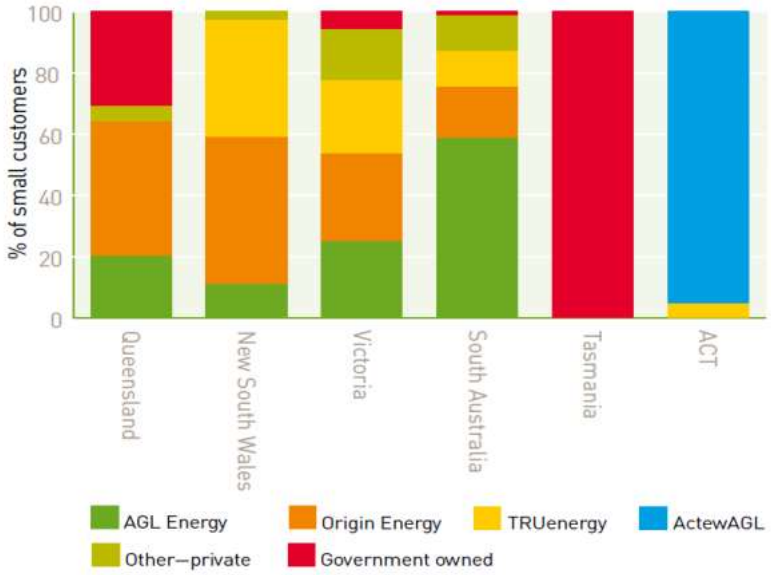
Bringing together Queensland, New South Wales, Victoria and South Australia – as well as Tasmania following the completion of the Bass-Link in 2006 – the NEM facilitates over $11 billion of trade each year, and meets the demand of over nine million end-use consumers (ACCC, 2011).

The scale of these achievements should not be under-estimated. In 2005, the International Energy Agency described Australia as a "pioneer" of energy sector microeconomic reform. The OECD has also stated in respect to energy that Australia should serve as a "reform model" for other countries.

But while Australia has undoubtedly come a long way from the days of single, vertically integrated utilities under full public ownership, reform momentum has stalled.

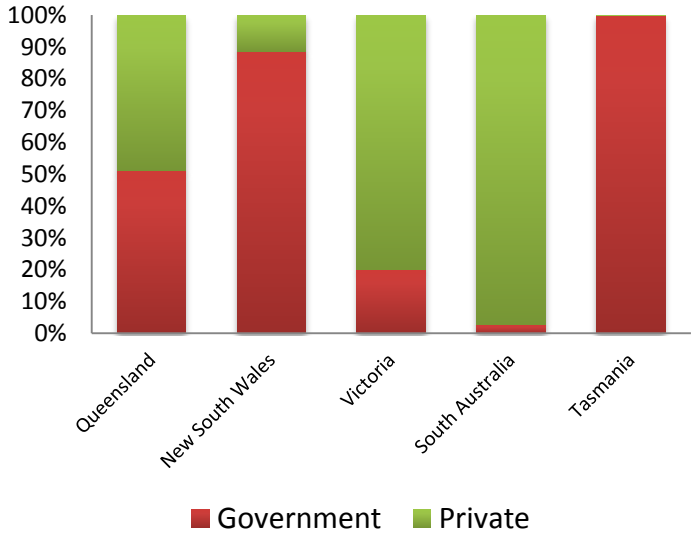
Only Victoria and South Australia have achieved the fundamental step of establishing a wholly private electricity market; and only Victoria has achieved the final step of removing retail price regulation. Other NEM states retain a confused part-public, part-private structure, which serves to frustrate the full benefits of an interconnected, competitive electricity market. Figure 1 and Figure 2 below provide an analysis of the current structure of the retail and generation sectors in Australia.

Figure 1 - Electricity retail market share (small customers) By Jurisdiction, 2011



Source: (ACCC, 2011)

Figure 2 - Installed generation capacity (& ownership) By Jurisdiction, 2011

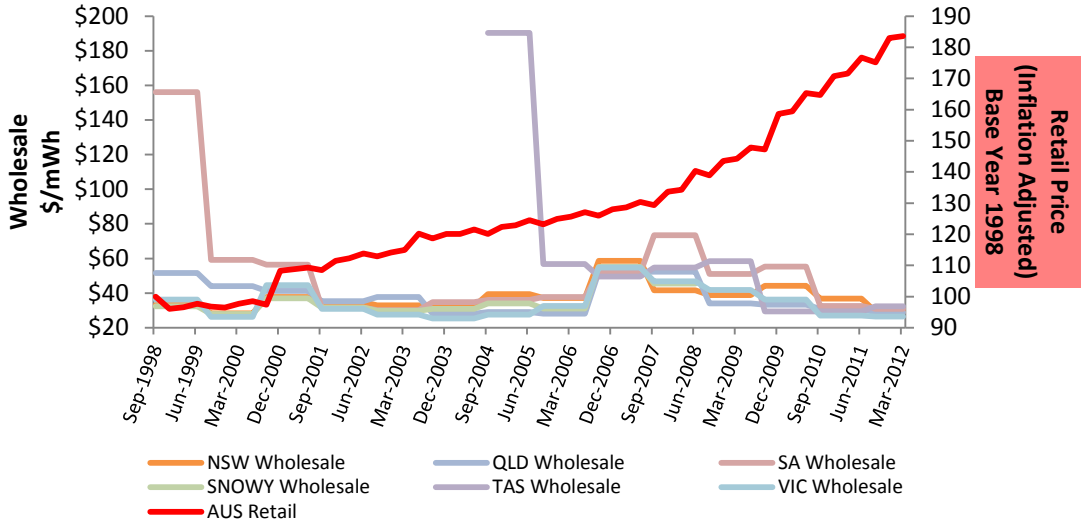


Source: IPA Analysis based on (ACCC, 2011)

As a consequence of this failure to reform, Australia continues to suffer inefficient pricing, substantial cost of living pressures and an erosion of its relative competitiveness. It has also meant that the development of a properly-functioning NEM has yet to reach its logical conclusion.

The impact of the failure to achieve fundamental reform in Tasmania, Queensland and New South Wales has also been borne by electricity consumers (be they business or domestic) in those states through higher electricity costs. Figure 3 below, shows that the failure to establish an efficient market price is ultimately accruing through a marked divergence between retail prices and wholesale generation costs. While wholesale costs have tracked downwards in recent years, retail prices have continued to increase.

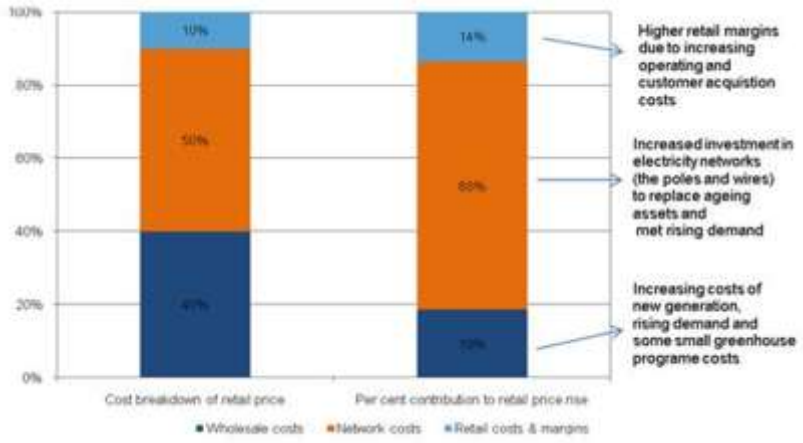
Figure 3 - Wholesale Cost vs Retail Price



Source: IPA Analysis 2012 based on ABS and AEMO data

While there is considerable variance across states, Figure 4 below shows that sharply rising network investment has been a key factor underpinning the decoupling of retail and wholesale prices.

Figure 4 - Electricity costs and their contribution to current price rises in 2010



Source: Garnaut Review Final Report, 2011

Much of this investment has been non-discretionary investment to renew ageing assets and deal with increased reliability standards. But equally, a significant proportion of this capital investment is directly attributable to rising peak demand. According to one estimate, up to a third of the $45 billion in planned capital expenditure on networks between 2010 and 2015 is attributable to peak demand growth (iGrid, 2011). As such, even a small reduction in peak energy demand can yield substantial savings in associated generation and network costs.

Ensuring an efficient price signal at each stage of the supply chain represents the most effective and enduring means of reducing peak demand growth, and in-turn reducing the impact of avoidable network investment on retail prices.

Establishing an efficient market price is dependent on establishing an efficient market, which in turn demands reform to deliver a wholly private NEM, as well as retail price deregulation.

2 A CLEAR REFORM PATHWAY

2.1 ESTABLISHING A WHOLLY PRIVATE MARKET

The benefits of a wholly private electricity market are long established in Australia. In 1991, the Industry Commission (now the Productivity Commission) found that privatisation was the best way to realise efficiencies and lower prices (Industry Commission, 1991).

The Commission, whose report became a blueprint for reform in Victoria and later South Australia, cited the formidable barriers to achieving full competition and optimal efficiency where government remained a direct market participant (Industry Commission, 1991). The Commission stated:

> *"Market disciplines which apply to private organisations - such as the threat of takeover, the risk of bankruptcy and monitoring mechanisms associated with listing on sharemarkets – do not apply to government bodies (irrespective of whether they are corporatised). Moreover, even with a corporatised public body, there is always the possibility that government will interfere in operating decisions and apply pressures for short term political ends which will damage economic performance. Consequently, there is the potential for greater efficiency in a private enterprise than in a public enterprise."*

Finding that private ownership *"carries with it disciplines which cannot apply to public utilities, irrespective of whether they are corporatized",* the Commission recommended the sale of publicly-owned generation assets to remove ongoing constraints associated with public ownership, and to permit faster rationalisation of management and work practices.

While finding that ownership in the networks sector is "a more complex question", the Commission stated that the market disciplines applying to private generation are equally relevant to networks, recommending that governments sell *"at least some of their distribution assets, with further sales dependent on an evaluation of the comparative performance of public and privately owned distributors."* The Commission also cited the fact that private firms already participate in electricity distribution in many other countries, including Denmark, Germany, Japan, Sweden and the United States of America.

In 2007, the Energy Reform Implementation Group (ERIG), appointed by COAG to provide independent expert advice on energy sector reform, also made privatisation a key recommendation (Energy Reform Implementation Group, 2007). In respect to generation, the ERIG found that government ownership in some jurisdictions *"causes serious concerns about competitive neutrality, with perceptions held by private investors that there is no level playing field between publicly owned and privately owned assets".*

The ERIG was unambiguous in its recommendations, stating that *"privatisation of even one element of the contestable energy chain would assist in driving more competitive outcomes, improve efficiency, and therefore achieve better outcomes for users of energy."*

In addition, the ERIG quantified that privatisation and associated regulatory reforms would increase real GDP by about $400 million a year (in 2007 dollars), and could reduce retail prices by as much as 2 per cent (Energy Reform Implementation Group, 2007). The 2011 NSW Special Commission of Inquiry into the Electricity Transactions (the "Tamberlin Inquiry") provided further support for a wholly private market. As well as calling for the privatisation of retail and generation businesses, the Inquiry found that privatisation of networks businesses *"would lead to efficiencies over time"*. The Inquiry's final report stated:

> *"Overall, the evidence before the Inquiry tends to support the view that privatisation of the network businesses would lead to efficiency gains over time. This would result in more effective capital investment, which should result in a reduction in the charges permitted to be levied for the business in the next regulatory period.*

This section will explore the case for, and pathway for achieving, privatisation across the retail, generation and networks sectors.

2.1.1 GENERATION

The electricity generation sector is generally regarded as one of the success stories of the NEM, with the greatest exposure to competitive market forces.

The bidding system that serves to match supply with demand has seen wholesale electricity prices reduce or stay flat in real terms over the 14 years since the NEM was established (AEMO Average Price Tables, 2012). Regulators have also taken note of the impact of lower wholesale supply costs, with the NSW Independent Pricing and Regulatory Tribunal (IPART) stating that the decreasing cost of generation prevented an even greater price rise in the 2012-13 round of retail price determinations.

An efficient, competitive, and cost-reflective wholesale market has also facilitated extensive investment by private industry. The ACCC's 2011 State of the Energy Market report found that the three largest private energy companies – AGL, Origin, and TRUenergy – accounted for a full 58 per cent of new generation capacity commissioned or committed in the NEM since 2007, while collectively generating about 30 per cent of total electricity.

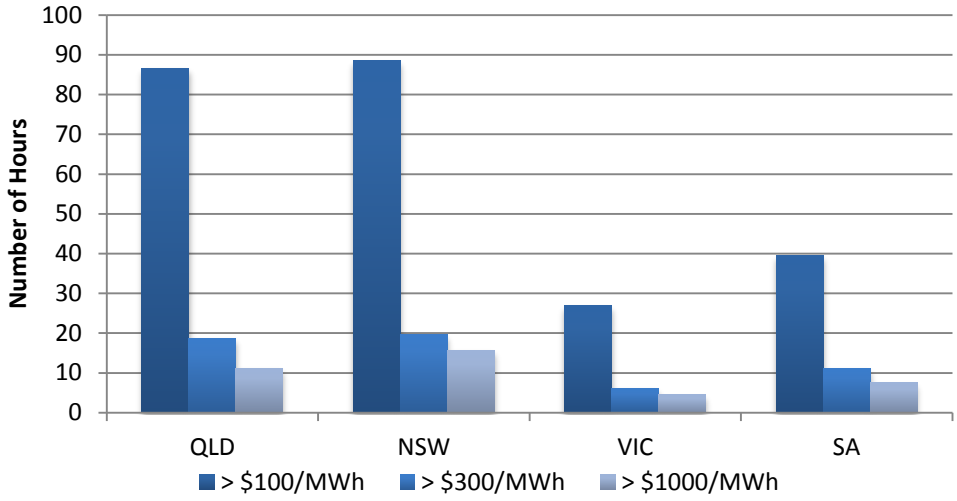
The efficiency of the wholesale sector has also enabled electricity retailers to perform one their key economic functions much more effectively. As a bridge between the wholesale market and the consumer, retailers are responsible for reconciling the low risk appetite of consumers with the highly volatile wholesale electricity market. In the NEM, private retailers have been able to mitigate this risk by acquiring existing or commissioning new generation capacity (ACCC, 2011). This would not have been possible without competition-inducing market settings and a stable regulatory framework.

But while electricity generation is rightly touted a success story, reform in the sector has yet to reach its logical conclusion. While Victoria and South Australia have fully privatised their generation assets, the Queensland, Tasmania and Western Australian governments have retained a significant market share, distorting efficient price signals and depriving private retailers in those states with an effective hedge against price volatility.[1]

One of the ways that continued government ownership manifests itself in this otherwise competitive market can be seen in Figure 5. The graph shows the number of hours during 2010-2011 where spot prices in the NEM went above $100, $300, and $1,000 per megawatt hour. A clear distinction can be seen between NSW and Queensland, two states with significant public ownership of generation assets, and Victoria and South Australia, where the wholesale market is entirely privately owned, with numerous competitive players. At least in-part, this divergence can be attributed to the continued presence of legacy, government-owned generators.

[1] The NSW Government has legislated the sale of generation assets.

Figure 5 - Number of hours of high spot prices by region 2010-11



Source: (Australian Energy Market Operator, 2012)

The AEMO's 2012 Electricity Statement of Opportunities (ESOO) noted that this price distortion may encourage market participants to install expensive – and avoidable – peaking generation capacity, seeking to take advantage of the more regular incidences of high wholesale prices. A further concern is the effect that high spot prices have on the retail sector in those states, in respect to reconciling the low risk appetite of consumers with a highly volatile wholesale electricity market.

The barriers to competition posed by continued government ownership was also a key factor underpinning the NSW Government's decision – announced in September last year – to progress with a full sale of all remaining state-owned generation assets.

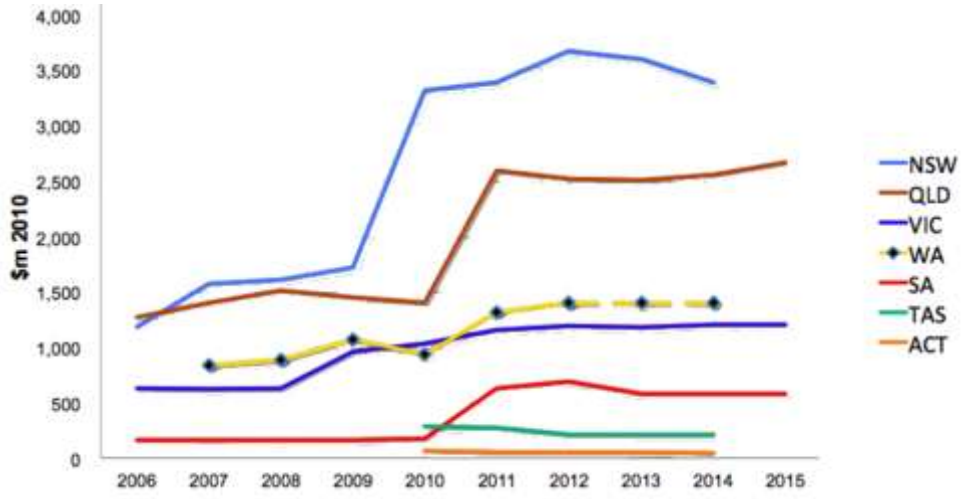
2.1.2 TRANSMISSION & DISTRIBUTION

Privately owned and operated transmission and distribution businesses are a further critical component of an optimally efficient electricity market. Private network ownership has also been a key factor underpinning Victoria's lower price rises relative to other NEM states.

As outlined earlier in this submission, a considerable proportion of network spending is attributable to rising peak demand. However, the fact that network spending has been higher in some states than in others suggests that other factors are at play.

In Queensland and New South Wales, capital spending per customer has consistently outstripped that of Victorian and South Australia, where networks are privately owned and operated. Figure 6 below shows the planned capital expenditure of network businesses broken down by state, as permitted by the most recent price determinations. Queensland and NSW are shown to have experienced an unprecedented jump in investment not seen in any other jurisdiction.

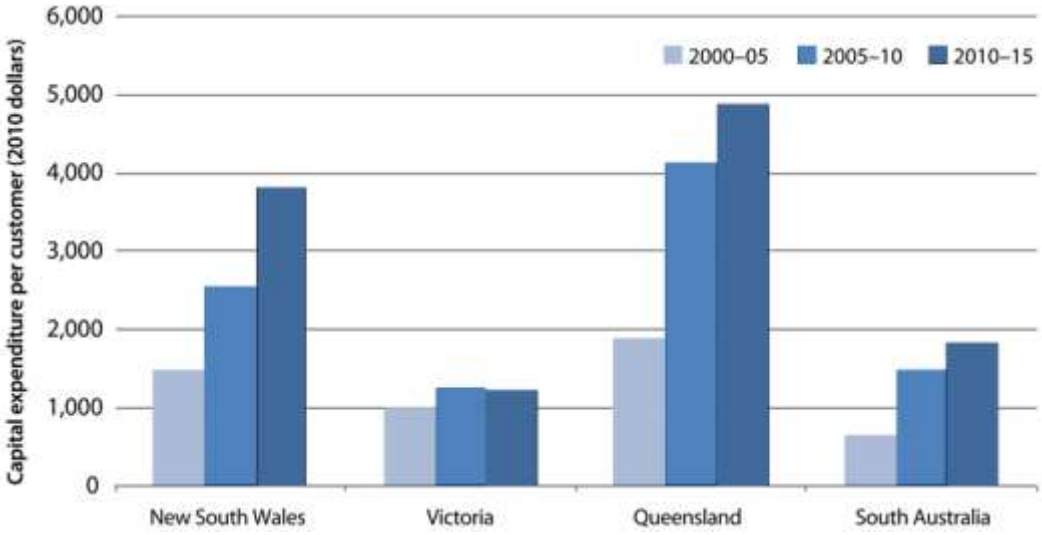
Figure 6 - Electricity Network Capital Expenditure by Jurisdiction, 2006 - 2015



Source: (iGrid, 2011)

This higher relative investment in Queensland and New South Wales becomes even more evident on a per customer basis (see Figure 7).

Figure 7 - Real capital expenditure per customer



Source: (EUAA, 2010, p. #59)

While the state-based regulatory frameworks in which network companies operate will clearly impact investment levels, this impact is relatively modest in comparison to the impact of peak demand growth. The AEMC's recent review of distribution reliability outcomes and standards in NSW found that a modest reduction in reliability outcomes would reduce prices for the average household by $3 a year – while an extreme reduction would deliver a $15 a year saving (AEMC, 2012).

Comparatively, there is strong evidence to suggest that network spending is lower, and quality of service higher, were networks are privately owned and operated (EUAA, 2011). This was explicitly recognised by the 2011 Garnaut Review, which found that *"government owners have an incentive to overinvest because of their low cost of borrowing and tax allowance arrangements"* (Garnaut, 2011).

In addition, Garnaut found that spending by publicly-owned networks is influenced by *"political concerns about reliability of the network, and about the ramifications of any failures, reinforce these*

incentives." This has been subsequently supported by the 2011 NSW Special Commission of inquiry into the electricity transactions, which stated that evidence before the Inquiry *"tends to support the view that privatisation of the network businesses would lead to efficiency gains over time".*

Victoria once again provides Australian policymakers with a first-hand demonstration of the benefits of network reform. According to a 2011 Ernst & Young study, network costs in Victoria decreased by 9 per cent in real terms (on a per customer basis) between 1996 and 2010. Over the same period, per customer network costs in New South Wales and Queensland increased by 65 per cent and 105 per cent respectively (Ernst & Young, 2011).

With New South Wales and Queensland network businesses expected to spend three times the capital expenditure (per customer) as their Victorian counterparts over the next five years, governments can no longer ignore the case for an overhaul of network ownership (iGrid, 2011).

2.2 RETAIL PRICE DE-REGULATION

2.2.1 FACILITATING A COMPETITIVE RETAIL MARKET

With the exception of Tasmania and Western Australia, there are no longer any legislative barriers to consumers switching electricity provider. There are, however, considerable regulatory barriers to the development of a competitive retail market in some states.

The continued reliance by governments on retail price regulation, as well as the use of other blunt tool approaches such as price freezes, may offer energy consumers a temporary reprieve, but longer-term serves to reduce retail competition and discourage private investment in new generation capacity. The impact on retail competition has been clearly evidenced by the fallout from the recent Queensland Competition Authority (QCA) determination and prize freeze, with several large retailers warning that ongoing instability could force their exit from the market in that state.

Western Australia, whereby taxpayers are being required to subsidise energy costs to the tune of $1.4 billion over four years, should also serve as a stark warning to other states about the broader fiscal impacts of artificially pegged prices.

The de-regulation of retail prices where a competitive retail market exists has also been supported by the Australian Energy Market Commission (AEMC). In its 2008 Review of the effectiveness of competition in electricity and gas retail markets in Victoria, the AEMC stated that effective competition *"protects consumers against the exercise of market power as firms strive to deliver goods and services consumers demand at least cost and to improve their products, services and processes"*.

The AEMC has also stated that where competition is providing choice and efficient outcomes for consumers *"there is no need for retail price regulation"*, and that maintaining price regulation in an effectively competitive market *"adds unnecessarily to retail costs and distorts effective functioning of the market to the detriment of consumers".*

Victoria provides Australian policymakers with a first-hand demonstration of the benefits of a fully deregulated retail electricity market. In particular, the Victoria experience has shown that effective retail competition will deliver efficient, reliable and safe supplies of energy, at the same time maintaining the balance between supply and demand over the longer term.

Based on customer switch rates, Victoria is now widely recognised as the most competitive electricity market in the world, with one in four consumers changing their energy provider every year.

2.2.2 ACHIEVING AN EFFICIENT PRICE SIGNAL

Price impacts aside, retail price deregulation also represents the most effective means of dealing with the peak load problem by assisting consumers to better manage their energy use.

The removal of retail price regulation in all NEM jurisdictions is a critical step towards achieving efficient price signals, and to ensuring regulatory settings act as an enabler, rather than a barrier, to effective demand management. The removal of retail price regulation would also serve to create a stronger business case for the wide scale rollout of smart meters by retailers, Energy Service Companies (ESCO) and network businesses.

By distorting price signals, flat retail tariffs effectively dilute the incentive for consumers to change their consumption behaviour. The resulting growth in peak demand has required considerable capital

investment in network capacity which is used for just a few days each year. The CSIRO has estimated that almost a third of approved capital expenditure on distribution and transmission networks is driven by growth in peak demand (see Figure 8). Clearly, a regulated, flat tariff structure is incapable of efficiently accommodating today's load profile, without driving inefficient investment.

Figure 8 – Avoidable network costs relative to total network capex ($m 2010)

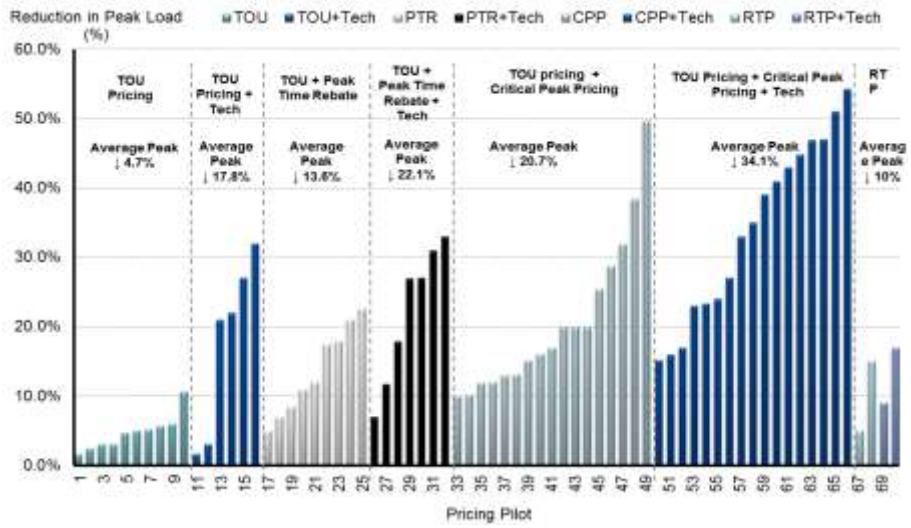
Source: (iGrid, 2011)

In the context of Australia's incredibly broad service area it is also crucial for government to recognise that a "one size fits all" strategy of Demand Side Participation (DSP) is unlikely to be optimally effective. Rather, policymakers must focus on achieving an efficient price signal between retailers and consumers that will enable the market to tailor demand management approaches.

Energy companies in Australia and overseas have undertaken countless pilot trials of more cost-reflective pricing methods to identify which is most effective at managing demand. Within Australia alone, estimates suggest upwards of 60 demand management trials have been conducted; including Direct Load Control (DLC), Time of Use (TOU), Critical/Dynamic Peak Pricing (DPP), Real Time Pricing (RTP) as well as various combinations of these.

Aside from endorsing demand management as an effective means of reducing peak demand, trials have shown a high variability in the effectiveness of different demand management approaches (see Figure 9 below).

Figure 9 – Demand Management Trial Results

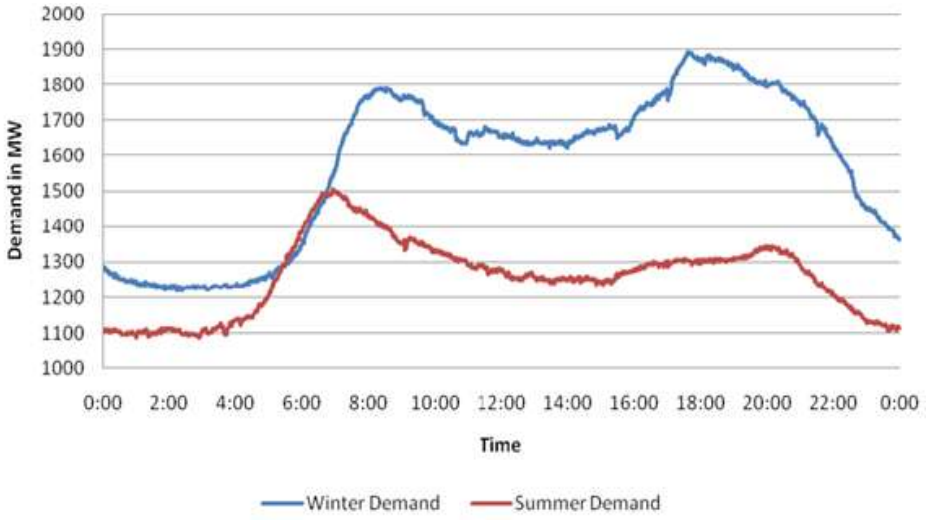


Source: AGL, 2012

Clearly, the effectiveness with which demand can be managed is dependent on a number of factors, including the specific load profile of a given area, the types of customers served, local climate conditions as well as the facilities available to electricity users. For example, some DLC schemes are designed to specifically target the increased use of air conditioners in Australia.

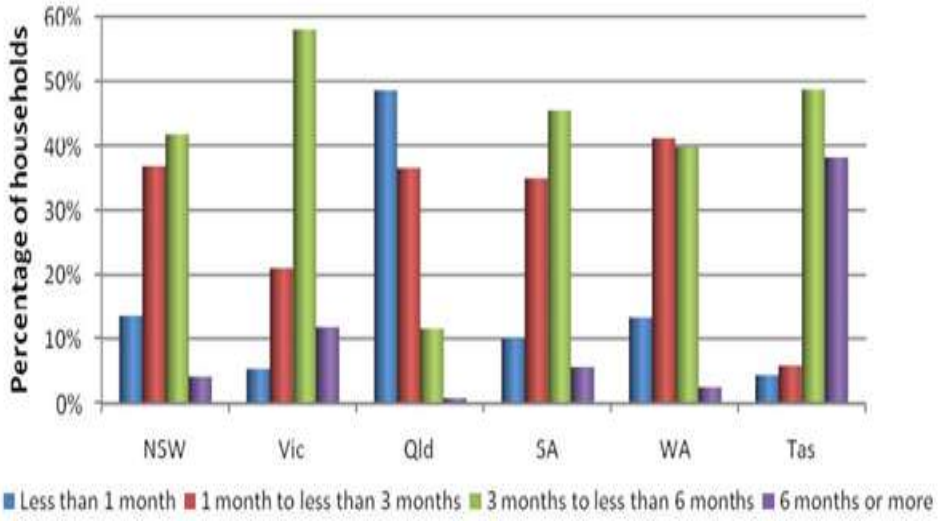
However, approaches targeted at reducing peaks resulting from the use of cooling systems in summer months are unlikely to be effective in cooler climates such as Tasmania or the Southern Tablelands of NSW, which experience relatively higher winter peaks. Conversely, a scheme targeting residential space heating in winter would be of limited value in states such as Queensland (see Figure 10 and Figure 11).

Figure 10 – Daily Load Curves for Winter and Summer Peak Tasmanian Demand



Source: (Electricity Supply Industry Expert Panel, 2012)

Figure 11 – Residential Space Heating – Months of Use (Per Annum)

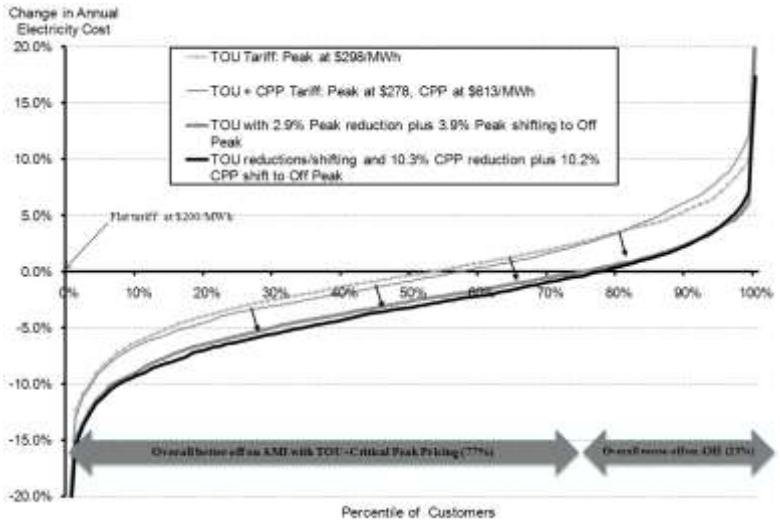


Source: (Electricity Supply Industry Expert Panel, 2012)

While the need to move away from flat tariffs towards more cost reflective and flexible pricing is widely accepted achieving this goal will not be possible without the widespread rollout of enabling technology, such as smart meters. With the exception of Victoria, smart meters have yet to be widely rolled-out in the NEM.

The slow rollout of smart meters can be at least partly attributed to the cost of installation and disagreement over who should fund the installation of smart meters, given the varying benefits that would be realised at multiple levels of the supply chain. Establishing efficient price signals at every stage of the electricity supply chain would assist in overcoming this financial barrier, as it would enable end users to better respond to changes in price in order to reduce their electricity bill. It would also enable retailers and networks to reduce their exposure to risk by charging prices that better reflect the efficient cost of supply. Conservative estimates suggest that when taking into account the likely demand response, 77 per cent of electricity customers could be better off under flexible pricing arrangements (see Figure 12) (AGL, 2012).

Figure 12 – Percentage Change in Electricity Costs



Source: (AGL, 2012)

Of course, the fact that consumers would be better off does not necessarily ensure that consumers would take appropriate action. However, the incentive for behavioural change would be greatly enhanced through efficient price signals and a competitive market environment, where retailers and Energy Service Company (ESCO) have a strong financial incentive to pursue new customers.

The experience in the large industrial sector, which has highly flexible and cost reflective price structures, serves as a valuable guide in predicting likely market developments. SP Ausnet, in their submission to the AEMC's Power of Choice review, noted the existence of 17 third party customer consultants and agents or ESCOs offering value added services to large customers in order to help minimise their costs. This was observed in the period following the introduction by SP Ausnet of Critical Peak Pricing for their large industrial customers.

Clearly, the introduction of flexible pricing for small customers should be accompanied by appropriate safeguards for those unable to adequately adjust their behaviour. Crucially however, such safeguards must be kept external rather than internalised within the market.

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