Australian Power & Gas

14 September 2012

Secretary
Senate Select Committee on Electricity Prices
Parliament House
Canberra ACT 2600

Via email: electricityprices.sen@aph.gov.au

To whom it may concern,

Submission for the Senate Select Committee on Electricity Prices

Australian Power and Gas Pty Limited (**APG**) welcomes the opportunity to provide a submission to the Senate Select Committee on Electricity Prices (the **Committee**) to support its inquiry (**inquiry**) on the causes for increasing electricity prices in Australia and options and means for reducing energy costs.

APG is a Tier 2 energy retailer supplying electricity and gas to customers in Victoria, NSW, and Queensland. Commencing operations in 2007, APG has grown its customer base across three states to approximately 341,000 customers. APG currently serves household energy consumers and will focus its submission to the Committee around its experience in serving residential customers in the states in which it operates. Therefore, it will not be responding point by point to the Committee's Terms of Reference (**ToR**).

In its role as a residential retailer, APG is keenly aware of the impact of increasing electricity prices on its customers. As the owner of the consumer relationship to their energy service, APG must directly manage customer concerns over the growing cost of energy, which are driven by system inefficiencies that consumers cannot influence through reducing their consumption, let alone wholly understand. Retailers are also limited in their ability to influence the major drivers of price increases including government policies and network infrastructure.

As the Committee is aware, there are numerous government consultations and policy changes underway both at the federal and state levels at address a number of issues affecting electricity prices raised in the Committee's ToR. The successful development of energy policy and efficient regulation remains a shared responsibility between the Commonwealth and the states. Therefore, APG urges the Committee to utilise these current efforts to inform the inquiry rather than disrupting initiatives already in progress or restarting those that have already been determined to be excessively costly or inefficient to industry and consumers.

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Electricity price increase drivers

While energy costs remain a modest portion of the average household income, approximately 2.6% according to the Australian Bureau of Statistics[1], substantial increases over recent years have caused consumer backlash against their energy retailer and policy makers. There is no easy solution as the increasing price trend is driven by several interconnected factors from APG's perspective, including:

- Changes in consumer behaviour including increased use of air conditioning and home appliances, and growth in the overall size of homes;
- Continuing regulated electricity pricing structures which mask true cost of energy and therefore distort energy consumption choices;
- Inefficiencies in capital investment to meet capacity, particularly to meet increasing peak demand; and
- Increasing compliance costs for energy suppliers and failure by policy makers to implement regulatory reforms.

APG will seek to address these factors in the context of issues raised by the Committee through its experience in energy retailing.

Retail price deregulation

Retail price deregulation remains an unfulfilled market reform which was agreed to by the Council of Australian Governments (**COAG**) in 2006. APG strongly supports the full deregulation of retail energy prices where effective market competition exists as determined by the Australian Energy Market Commission (**AEMC**). Regrettably, removal of regulated energy pricing in markets such as NSW and Queensland where there is market competition driven by the activity of Tier 2 energy retailers has proved politically sensitive due to concerns about potential "price shock" with the removal of effective price caps. This is particularly true as electricity prices have increased substantially in recent years.

From the retailer perspective, price regulation in the NSW and Queensland markets remains a business risk, particularly for Tier 2 retailers whose cost structures are generally not reflected in modelling used by regulators to determine regulated prices. In NSW and Queensland, where the regulated retail price acts as an effective price ceiling, the methodologies used must reflect the costs of the full suite of retailers operating in the market in order to foster realistic and fair competition. Further, decisions by government to adjust methodologies used for determining regulated prices at short notice, as occurred in Queensland for the current fiscal year, undermine retailers' ability to operate in those markets and provide consumers the competitive products that they seek.

In 2009, Victoria successfully deregulated retail energy prices following the AEMC's determination that effective competition exists in the market. Much of the success of deregulation for consumers has been driven by Tier 2 retailers who offer cost effective and innovative products to consumers that encourage them to seek a better deal from a new

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[1] Australian Bureau of Statistics, *Household expenditure survey, Australia 2009-10,* cat no 6530.0, ABS Canberra, 2011.

energy provider. Victoria is arguably the most competitively active energy market in the world, with switching rates between retailers being above 25%.[2] The competitive nature of the market has been balanced with relatively stable price increases since 2009 across the board coupled with strong protections for consumers.

Innovation and competition in the Victorian market will only be enhanced with the completion of the roll out of smart metering technology, which will allow retailers to provide more innovative products and services that will help consumers better chose how they will manage their energy consumption and reduce their energy bills. It is anticipated that increasing innovation as a result of smart metering technology may further increase the competitive nature of the Victorian market.

As stated in the Commonwealth's *Draft Energy White Paper,* regulated energy pricing structures encourage inefficient patterns of consumption and unfairly distribute costs across consumers.[3] Absent price deregulation, consumers' ability to make choices about their energy consumption based on the true cost of energy will never be realised. Price regulation also reduces the incentive of retailers to develop innovative pricing and tools for consumers to help them manage their energy costs as pricing structures remain flat. Unless consumers, from residential through industrial, are able to make able to make choices about their energy use based on real price signals, market issues such as peak demand cannot be solved.

While pricing regulation remains within the policy ambit of the states, the Commonwealth has a role to play in working with state Energy Ministers to advocate for increasing efficiencies in the energy market and meeting reform commitments, which must include retail pricing deregulation. It is only through open market competition where consumers will begin to see the benefits of understanding the true cost of energy and the impact of their consumption choices on their energy bill.

Technologies to help consumers understand their energy choices

APG, along with other energy retailers, welcomes the implementation of smart metering and other technologies that will assist consumers in making informed and effective choices in their energy use. However, as noted above, the full impact of the implementation of smart metering and resulting innovation in pricing and products will not be felt fully by consumers until pricing regulation is removed allowing for more flexible pricing arrangements.

While APG believes the roll out of smart metering and other technologies should be driven by consumer choice and not government mandate, it has been actively involved in the government-led roll out of smart meters in Victoria. While still in progress, the Victorian experience has already provided valuable lessons to policy makers and retailers about the importance of consumer engagement and education about the benefits of such technology changes. Mass market consumers in Victoria remain uncertain of what benefits they will see with from their smart meter, particularly whether it will reduce their energy bill. International experience in smart meter implementations have proven that any roll out of new technology

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[2] VaasaETT 2010, World Energy Retail Market Ranking Report – 5th Edition, December 2010
[3] Commonwealth of Australia, December 2011, *Draft Energy White Paper – Strengthening Foundations for Australia's Energy Future.*

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must be coupled with strong consumer engagement and time to allow consumers to accept changes and allow sufficient time for consumers to adapt their behaviour to derive the benefits. Such themes are echoed in the recent AEMC *Power of Choice* Draft Report.[4]

As a member of the Energy Retailers Association of Australia (**ERAA**), APG has been directly involved in the development of a number of position papers on the deployment and use of smart meters and other technologies in the National Electricity Market (**NEM**). As part of ERAA's submission to the Committee, we understand it has provided these papers, and we encourage the Committee's consideration of the issues raised by industry in the papers.

Infrastructure investment inefficiencies and the issue of peak demand

Investment in electricity generation and network infrastructure has largely been driven by the need for supply capacity to reliably meet the expected highest demand during a period of time or in a locality, or forecast peak demand, which by its nature, may only exist for a few days per year. As noted above, the change in consumer behaviour to increase the use of air conditioning and other electrical appliances, coupled with the high expectation of system reliability has driven a steady increase in peak demand relative to standard demand. With capital investment largely driven to meet peak periods, the result is a large proportion of Australia's electricity infrastructure sitting underutilised during non-peak periods, which is clearly an inefficient utilisation of capital across the energy system. The costs of this capital investment are eventually borne by consumers in the form of higher electricity prices.

The issue of peak demand is not new for policy makers at both the federal and state level, and APG recommends that the Committee as part of its inquiry to assess the breadth of information available from industry and government to help inform its review. From its experience with household consumers, helping address peak demand will require:

- Extensive education of consumers about the impact of their energy consumption and behaviour on the energy system and how that translates into increased energy bills;
- Ensuring consumers have an accurate understanding of the true cost of their energy through full retail price deregulation;
- Providing consumers technologies whereby they can in near real time understand their consumption and innovative choices which allow them to make choices about their consumption in an informed way; and
- Providing incentives through pricing which may allow willing consumers curtail their consumption during peak periods.

However, not all propositions are suitable for all residential consumers. Further, there must be sufficient engagement by government and industry to build consumer understanding of how they can manage demand and allow time for behaviour changes to be adopted.

Nevertheless, a percentage of large commercial and industrial (**C&I**) consumers already actively manage their demand as they are keenly aware of their electricity use, its cost to their business, and where they can control demand while meeting their business objectives.

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[4] Australian Energy Market Commission, 6 September 2012. *Draft Report: Power of Choice – giving consumers options in the way they use electricity.*

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Expansion of participation in active demand management by C&I consumers in the short to medium term may result in a slowing of peak demand.

Addressing peak demand through effective demand side participation by both C&I and mass market consumers is widely addressed in the AEMC *Power of Choice* Draft Report. APG as a market participant will be reviewing this Draft Report with high interest.

Increasing compliance costs and implementation regulatory reforms

In recent years, energy retailers have felt the increasing cost of complying with the complex framework of state and national regulation and new policy implementation. While each measure independently may have value for consumers, the energy sector or the environment, the compounding of each new measure with existing rules and regulations has resulted in regulatory inefficiencies that retailers are required to manage, which increases their cost of serving consumers.

Bearing in mind the increasing national profile of the energy market participant as a result of formation of the NEM, market reforms implemented in the 1990's were in part designed to harmonise systems and processes to increase market efficiency. The harmonisation of state based consumer protection schemes under the National Energy Customer Framework (**NECF**) was designed to increase cost efficiency and raise the bar on consumer protections. APG recognised the benefits of alignment under one consumer regulatory scheme versus multiple state schemes. APG invested heavily in capital and resources to meet the 1 July 2012 NECF implementation date set by the Ministerial Council on Energy in 2010. Regrettably, every state in which APG operates has failed to date to implement NECF. The delay in APG's ability to see value for its investment coupled with continuing regulatory uncertainty at the state level has resulted in high costs, which are ultimately felt in higher energy prices by consumers and industry.

An area of concern raised by the Committee in its ToR is arrangements to support vulnerable customers with their energy bills. APG has in place a number of processes to support its customers who may be experiencing financial difficulties, including a hardship program. NECF sought to improve protections for customers experiencing financial difficulties by regulating and setting performance measurements for hardship programs. Delays in the implementation in NECF have resulted in vulnerable consumers in a number of states in the NEM not being able to benefit from these protections.

A number of issues raised in the Committee's ToR will all be well served by the prompt implementation of NECF including the benefits of consumer advocacy, information, choice, protection measures, and increased performance reporting. While the decision to implement NECF now rests at the state level, APG urges the Committee in its review to thoroughly assess the impact of the continued cost of delay on energy consumers.

A further area of increasing compliance costs is the proliferation of green and energy efficiency schemes. APG understands the role that green and energy efficiency schemes play in helping consumers more actively manage their energy costs and their role in government efforts to protect the environment. However, as the owner of the consumer relationship, explaining the complexity of these schemes, their cost to industry to implement, and the direct cost impact of these schemes on consumers' bills APG believes needs to be more of a shared responsibility between government and industry. While industry is happy to play its part, this should not to the financial and reputational detriment of retailers who are required to carry government messages to consumers and incur costs without sufficient support from government.

While energy efficiency and other renewable energy schemes may be reducing overall energy demand, their impact on a key driver of energy price increases, peak demand, is negligible. APG actively participates in the energy efficiency schemes in each state in which it operates and also provides energy efficiency advice directly to its consumers. However, APG notes that costs of compliance with such schemes including administration, reporting and auditing are onerous and may negate much of the cost savings to consumers that the schemes were designed to provide.

In December 2011, the Department of Climate Change and Energy Efficiency and Department of Resources, Energy and Tourism released its *Issues Paper: National Energy Savings Initiative* which sought consultation on the harmonisation of state based energy efficiency schemes into a national scheme. APG would support the implementation of a single harmonised scheme as opposed to the number of state based schemes, provided that the new scheme was not more proscriptive and onerous than current schemes. The removal of state based schemes for a single, harmonised program will ultimately benefit consumers in reduced compliance costs for retailers.

APG appreciates the opportunity to share its experiences as Tier 2 energy retailer with the Committee as it assesses drivers for increasing energy prices and opportunities to help reduce energy costs.

Yours sincerely

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