Australian Chamber of Commerce and Industry

Inquiry into retail electricity supply and pricing

Submission to the Australian Competition & Consumer Commission
30 June 2017

Introduction

The Australian Chamber of Commerce and Industry (Australian Chamber) welcomes the opportunity to provide this submission to the Australian Competition & Consumer Commission's (ACCC) inquiry into retail electricity supply and pricing.

Energy needs to be affordable, reliable and secure for both business and households. With that in mind, the Chamber seeks policies that will deliver a near-term reduction in electricity prices, followed by ongoing reductions in the real cost of energy over the longer-term. This requires a thorough examination of the key cost components facing electricity consumers. The Australian Energy Market Commission (AEMC) has identified these as network costs (40 to 55 percent of an electricity bill), wholesale and retail costs (40 to 50 percent of an electricity bill) and various federal and state environmental schemes (5 to 15 per cent).[1]

At the same time that prices have surged, parts of the network increasingly operate outside of technical security and reliability parameters and the market does not have a stable or credible policy covering emissions in the electricity sector beyond 2020.[2] The Australian Chamber demands urgent action to address these issues.

For a jurisdiction that has an inflexible workplace relations system and increasingly uncompetitive taxation system, losing our competitive advantage of cheap and secure energy has come as a shock to business in the past few years. South Australia now holds the unwanted title of the most expensive electricity in the world,[3] and despite being a world-class jurisdiction for LNG exports, domestic businesses are reporting above LNG net-back prices for gas supply contracts.

Australia is unfortunately an increasingly uncompetitive place to do business. Australia's competitors are embracing policies that make their economies more competitive, and Australia is falling behind. Over the past decade, Australia has fallen from 10th to 22nd on the Global Competitiveness Index.

Without exaggeration or hyperbole, it *is essential* that all businesses, no matter the size or sector, have access to affordable, reliable, and secure energy. It is a major policy failure that Australia cannot claim meet these three criteria.

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[1] AEMC (2016), *2016 Residential Electricity Price Trends*, http://www.aemc.gov.au/Markets-Reviews-Advice/2016-Residential-Electricity-Price-Trends

[2] The Emissions Reduction Fund technically can cover the sector but the baseline is higher than the sector average so does not practically apply. The Renewable Energy Target (RET) covers the electricity sector but was not designed to operate in absence, and has a number of design shortcomings.

[3] According to Bruce Mountain, CME Consulting – Dayman, I, (2017), *South Australia power price to rise to highest in the world on Saturday, energy expert warns*, ABC News http://www.abc.net.au/news/2017-06-28/sa-has-most-expensive-power-prices-in-the-world/8658434

Electricity prices - wholesale costs and retail competition

The Australian Chamber recognises that the current surge in electricity prices reflects a confluence of factors. At the wholesale level, this includes the displacement of traditionally affordable coal baseload generating capacity and the current inability of alternatives (especially intermittent renewables) to fill the void and provide security and reliability to the system. The electricity system does not appear to be appropriate or fit-for-purpose and has been adversely affected by policy uncertainty.

This changing dynamic has led to a changing role for gas, which is having upward pressure on prices. In some jurisdictions, gas is more frequently setting the wholesale electricity spot price. With more intermittent generation in the system, gas plants may also be relied upon less often, meaning they may offer higher prices to be dispatched in order to recoup costs.

This has generally occurred at a time when the productive capacity of some gas assets has been overestimated. This has resulted in some suppliers overextending themselves in contracting gas for export. The result has been a reduction in domestic gas supply and higher domestic gas prices. This in turn has led gas generators to bid into the market at higher price levels.

Overlaying these developments are concerns over competition at the retail level. Retailer's costs, network costs and margins make up the bulk of an energy bill. However there is very little data on the separate impact of the various elements (including wholesale costs) on a bill. This opaqueness in pricing makes it difficult to analyse the extent of anti-competitive behaviour, and how theoretical benefits of deregulation and market competition have practically benefited consumers. Regulators should be empowered to deliver this pricing transparency to the market. This might include public disclosure statements from energy retailers detailing the pricing and cost of past/future costs associated with operations and investments. The ACCC or an appropriate third party should have better information on costs and investments made by energy companies so that discounts/premiums can be passed on when suitable and necessary.

Retail price regulation itself has been progressively removed in Australia's Southern and Eastern states over the past 8 years. Victoria was first in 2009, followed by South Australia in 2013 and NSW in 2014. Retail prices were deregulated in South East Queensland in 2016.[4] Despite this, there is a sense among electricity consumers that the full benefits that a competitive market can deliver – lower prices and better service – have not been realised. At least not to extent that it could be.

The Australian Chamber notes the AEMC's 2016 finding[5] that retail competition was effective for the purposes of deregulation and that consumers were receiving a benefit. The Chamber notes, however, that this is a different proposition to whether competition is *sufficient* to deliver electricity prices that reflect the nation's vast energy reserves – that give Australian consumers and business a cost advantage relative to other nations. The answer to that question has very important policy implications in an increasingly competitive global market place. Moreover, the Chamber is of the view that the existence of asymmetric information and some of the behavioural biases that the AEMC refer to in its study, make survey based measures of competition in the retail electricity market much less valuable. The question can only be genuinely answered with reference to a plausible best case counterfactual provided by experts.

The sheer volume of Australia's energy reserves, should yield some of the lowest electricity prices in the world. Yet this isn't the case. Consequently, the Australian Chamber remains concerned that the

[4] Australian Energy Regulator (2017), *State of the Energy Market*, https://www.aer.gov.au/publications/state-of-the-energy-market-reports/state-of-the-energy-market-may-2017

[5] AEMC (2016), *Retail Competition Review*, http://www.aemc.gov.au/Markets-Reviews-Advice/2016-Retail-Competition-Review

retail electricity market may not be *sufficiently* competitive and that the full benefits of a competitive market are not being realised.

The high degree of market concentration across all states offers evidence in support of that. The Australian Energy Regulator notes that even after 8 years of competition, nearly 80 per cent of Victoria's retail electricity market is dominated by four providers (despite a larger number of retailers in the market). In NSW, 90 per cent of the retail market is dominated by three businesses, while in South Australia, two businesses control nearly 70 per cent of the market.

As outlined by the Grattan Institute shortly before this inquiry was announced, recent prices rises in Victoria have occurred due to an increase in the retail component of the bill. Unlike other jurisdictions that have seen increases in network costs, Victoria's network costs fell by 18 per cent in real terms from 1996-2013. Notwithstanding increasing wholesale costs because of the Hazelwood's plant closure earlier this year, a profit margin of around 13 per cent sees the retail component in Victoria account for a higher proportional of total costs comparted to other NEM jurisdictions. This is even though Victoria has introduced full retail competition and de-regulated prices in 2009.

While the existence of an oligopolistic market structure isn't proof, per se, that a market is not competitive, it is well accepted that oligopolistic markets are prone to interdependence and tacit collusion. The potential for anti-competitive behaviour by market participants is very high given the extent of market concentration and the ACCC needs to investigate the reasons for such a skew. The Australian Chamber's view is that this has not been adequately investigated with regard to energy markets including competition in the retail market. A high degree of vertical integration exacerbates issues of competition with the large retailers in NSW, Victoria and South Australia controlling 50-70 per cent of generation.

Either way, a more even distribution of market share between a larger number of firms is more likely to deliver and incentivise more competitive margins, pricing and service delivery. The Chamber's concerns relate to our estimate of what could be, if the market wasn't so heavily concentrated.

The Australian Chamber encourages the ACCC to use its powers to investigate the behaviour of retailers and whether an abuse of market power is leading to excessive profit margins. As with other businesses, the Australian Chamber does not want to see unnecessary red tape placed on retailers – however, it is important for parties across the energy supply chain to understand drivers for costs. Without this understanding, it will be increasingly difficult for the Federal and State Governments to take informed action on the many complex issues facing the sector.

With regard to the wholesale market, the availability and price of gas remains a significant concern for users, especially as the price rise has occurred at a time when domestic demand has levelled off[6].

Questions have also been raised as to whether there will be sufficient gas supply available, at low prices (or even the net-back Asian LNG price), to offset lost baseload electricity generation from displaced coal generators. This appears to be, at least in part, because the development of gas wells at the Gladstone LNG project have been slower than expected. The AER[7] state that "because the project lacks sufficient reserves to meet its LNG feedback stock requirements, it is sourcing substantial volumes of gas from outside its own portfolio, absorbing supplies that might have otherwise been available to the domestic market."

[6] Australian Energy Regulator (2017), p.67.
[7] Australian Energy Regulator (2017), p.81.

In that regard, the Australian Chamber welcomes the development of new gas reserves, particularly the Narrabri gas project in NSW and new exploration leases in the Surat Basin, but notes that these are not short-term remedies to either the price or availability of gas now.

Ensuring there is an adequate gas supply for domestic purposes is paramount and the Chamber welcomes policies to ensure an affordable domestic supply of gas. As part of that, the Australian Chamber also welcomes the ACCC's inquiry into the gas market and awaits the first report in October 2017.

Given the scope for gas to be used as a back-up for intermittent electricity generation provided by renewables (especially in South Australia) it would also be worth exploring the effect of generation uncertainty has on the operation of gas plants.

A lack of transparency on domestic gas contract terms and prices makes it difficult to know the true state-of-play with regard to the market. The Chamber believes that that greater transparency with respect to pricing and contract terms would be beneficial for the operation of the market.

Recommendations:

- For the ACCC to analyse whether the current generation mix and market structure is fit for purpose.
- That the ACCC and other regulators and operators, be given powers to determine and publish the disaggregated market costs at the retail and wholesale level including all derivative activity.
- Greater consistency and clarity in billing, marketing materials and customer information is needed. This would include using standardised terms and language, billing, clauses. A voluntary industry code could be a useful first step.
- For the ACCC in consultation with regulators and operators, investigate examples of price spikes and determine their causes.
- For the ACCC to analyse whether the proposed five minute settlement rule could reduce price spikes.

How are consumers incentivised to shift demand

Theoretical savings can be made by consumers altering their behaviour. Changing energy use patterns and using energy more cleverly has a role to play in lessening business' vulnerability to high electricity and gas prices. Businesses are open to looking at these options where possible, with time-of-use tariffs offering such an option to incentivise changes to peak loading. However, this incentive is not always clear or present, as indicated by a case study of a member below.[8]

A member of the NSW Chamber[9] is a minerals processor that employs over 100 staff in plants and warehouses located in regional and metropolitan Australia. The business has encountered significant issues when procuring both electricity and gas for its two sites in NSW and one site in Victoria. The business views minimising energy costs as business as usual, both during procurement as well as through process optimisation. It regularly seeks to reduce its peak demand (and corresponding demand charge), including through shifting its electricity use to off-peak where possible. The business believes there is inadequate incentives built into the electricity market to minimise its peak demand – the retailers have little incentive or scope to offer contracts to do this, and the networks don't discuss options and opportunities to reduce the peak demand of customers. Despite efforts, in 2017 this business is facing a 25-30% increase in its electricity bill compared with

[8] Initial provided in the Australian Chamber's response to the Finkel Review.
[9] Company has preferred to remain anonymous.

the previous year's bill. The business noted that the wholesale energy price component quoted in contracts for 2017 doubled between early 2016 and late 2016, from around $40/MWh to around $80/MWh.

The Australian Chamber welcomes efforts by the ACCC to investigate whether retailers are genuinely offering incentives to shift demand profiles.

Identifying All Classes of Consumers

Specific attention needs to be given to SMEs and large market customers in this review. Often, these groups are overlooked, with focus on very large energy consumers and households. The former, while clearly impacted by higher prices, do have internal expertise to manage volatility that large market customers and SMEs may not. Households, while in many cases vulnerable, are given considerable attention and rising prices on the back of Government policy is often addressed with specific Government household payments.

As routinely advocated by our member Business SA, large customer market is often glossed over or simplified in Government reports on how businesses are being impacted by electricity prices. Large market customers are not all 'big businesses', in fact most are not and are primarily SMEs which happen to be relatively energy intensive. These businesses might only spend as little as $50,000 to $100,000 per annum on electricity, but we've received examples where these companies have experienced up to a doubling of electricity costs. These businesses are price-takers in the contract market and cannot otherwise hedge against increasing rising electricity prices. The only retailers that can offer genuinely competitive pricing is firm dispatchable power – with the closure of baseload generation, this means there are fewer options than there once were.

The Australian Chamber is supportive of the ACCC investigating how the market for 'large market customers' works in the NEM. Given the effective lack of hedging across interconnectors, this should be done at a jurisdictional level.

National Priority, State Issues

The Australian Chamber supports a national, integrated approach to energy and climate policies and as far as practicable is not in favour of state schemes that duplicate national schemes. However, many decisions pertaining to energy policy are in the remit of State Governments, with the framework of the Council of Australian Government (COAG) Energy Council operating to align state approaches.

As the ACCC would therefore be aware, the terms of reference to this review will need to take account of the specific reasons for consumer outcomes across different jurisdictions in the National Electricity Market. As such, the Australian Chamber supports the submissions of its State Chamber and Territory members who are closest to the policies and regulations affecting their jurisdiction, and how consumers are impacted.

While the terms of reference are limited to the National Electricity Market (NEM), we ask the ACCC to be cognisant of the experiences of the Northern Territory and Western Australia. This is important for two reasons. The first is there may be some lessons from these jurisdictions to apply to the NEM. For example, the Chamber of Commerce and Industry WA (CCI WA) reports that large gas consumers are able to obtain multiple gas supply offers at reasonable prices, and that retail competition for gas supply is operating as intended. There are similar examples of functioning competition in the business segment of the electricity market.

The second is a risk that limiting the terms of reference to the NEM, recommendations are nevertheless made that have national consequences. This is most recently seen through the Finkel Review. While it's recommended Clean Energy Target was only modelled for jurisdictions in the NEM, as this recommendation would involve a national law and grandfather a national scheme in the Renewable Energy Target, it logically follows that Western Australia and the Northern Territory are in scope.

If the ACCC through this inquiry makes recommendations that would impact all jurisdictions, we recommend that the terms of reference later be expanded so that there are not unintended consequences for jurisdictions that are currently out of scope.

Summary

The Australian Chamber strongly supports the ACCC's inquiry:

- The Australian Chamber recognises that the current surge in electricity prices reflects a confluence of factors. At the wholesale level, this includes the displacement of traditional coal baseload generating capacity, higher gas prices, and intermittent renewables that do not have the same reliability or security characteristics of baseload generation. The generation mix does not appear to be appropriate or fit for purpose and has been adversely affected by policy uncertainty. Prices are also rising because of higher network costs, the extent to which differs across NEM jurisdictions.

- The Chamber recommends that:

  - The ACCC analyse whether the current generation mix and market structure is fit for purpose.
  - The ACCC and other regulators and operators, be given powers to determine and publish the disaggregated market costs at the retail and wholesale level including all derivative activity.
  - Greater consistency and clarity in billing, marketing materials and customer information is needed. This would include using standardised terms and language, billing and clauses. A voluntary industry code could be a useful first step.
  - The ACCC, in consultation with regulators and operators, investigate examples of price spikes and determine their causes.
  - The ACCC analyse whether the proposed five minute settlement rule could reduce price spikes.

About the Australian Chamber

The Australian Chamber of Commerce and Industry speaks on behalf of Australian business at home and abroad.

Our membership comprises all state and territory chambers of commerce and dozens of national industry associations. Individual businesses also get involved through our Business Leaders Council.

We represent more than 300,000 businesses of all sizes, across all industries and all parts of the country, making us Australia's most representative business organisation.

The Australian Chamber strives to make Australia a great place to do business in order to improve everyone's standard of living.

We seek to create an environment in which businesspeople, employees and independent contractors can achieve their potential as part of a dynamic private sector. We encourage entrepreneurship and innovation to achieve prosperity, economic growth and jobs.

We focus on issues that impact on business, including economics, trade, workplace relations, work health and safety, and employment, education and training.

We advocate for Australian business in public debate and to policy decision-makers, including ministers, shadow ministers, other members of parliament, ministerial policy advisors, public servants, regulators and other national agencies. We also represent Australian business in international forums.

We represent the broad interests of the private sector rather than individual clients or a narrow sectional interest.

Working for business.
Working for Australia

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