



8 February, 2008

Hon. Barrie Unsworth  
Chair  
Consultative Reference Committee

Attention: Zoe de Saram  
Department of Premier & Cabinet  
Level 39  
Governor Macquarie Tower  
1 Farrer Place  
Sydney NSW 2000

Dear Mr Unsworth,

The Energy Retailers Association of Australia (ERAA) welcomes this opportunity to comment on the work of the Consultative Reference Committee (CRC) in assessing the impacts of NSW electricity industry changes recommended in the Owen Report.

The ERAA is the peak body representing retailers of electricity and gas in Australia's National Electricity Market (NEM). Its members include publicly and privately owned retailers who provide retail energy to over 11 million customers. Some of our members are stand alone retailers while others combine retailing with a generation capability (sometimes referred to as "gentailers").

Given that membership base, our submission is not made on the basis of any ideological commitment to privatisation. We simply wanted to emphasise some key points about the market within which all energy retailers operate today. We also wanted to correct some misconceptions about future pricing which have been promulgated by opponents of Professor Owen's recommendations.

The first point we would make is that the most dramatic changes the energy retailing sector has seen in the last decade or so arose not from ownership changes, but from the National Competition Policy Agreements (NCP) of 1995. These led to the break-up of the traditional monopoly State utilities that had dominated the industry and saw new specialist businesses established for generation, transmission, distribution and of course, retail.

At the same time the Commonwealth and all States and Territories agreed to establish an interconnected wholesale market for electricity, the NEM, that stretched from North Queensland to South Australia. This market was to set prices for wholesale

electricity in half hourly increments on the basis of supply from generators and demand from retailers and was aimed at providing efficient investment signals for new generation along the East Coast.

As the NEM is subject to significant volatility, it has also introduced a new element of risk to retailers who have to purchase their electricity from a market moving in half hour intervals and supply it to customers at regulated prices or under fixed term contracts. As such, retailers, private or public, in essence have become intermediaries for consumers who provide an important service in ironing out the volatility of the wholesale electricity market. They are able to do this by negotiating bilateral contracts with generators, something which is referred to as hedging.

Hedging is made all the more complicated by the fact that a retailer's customer base is also subject to volatility. This is because under a policy of what is called Full Retail Competition (FRC), all customers in NSW, Qld, Victoria and South Australia have become contestable. As such the publicly owned retailers in NSW must compete with private retailers for customers, and vice versa.

The Committee must therefore have no social expectation of the State owned retailers that impedes their ability to compete with the private sector, and conversely, in line with the accepted principle of competitive neutrality, there must be no advantages provided to the State owned retailers in their battle with private retailers. That does not mean the industry is not a willing and active supporter of vulnerable customer policies or environmental initiatives. In a commercial sense what it means is that all retailers have to be able to charge cost reflective prices to their customers, something which the independent NSW regulator, IPART, has publicly stated is its objective in its current regulated price path covering the period 2007-2010. As a whole the ERAA does not believe regulated prices have reached cost reflective levels in NSW yet.

**Only with cost reflective tariffs, will it be possible to get the new generation investment which Professor Owen indicated was necessary in the middle of the next decade. For only with cost reflective tariffs will the price signal of a tightening of supply and demand come through and give investors the financial return to justify new investment. This will be the case in a private or publicly owned industry.**

Having said that, it is worth informing the Committee how a retail price that is cost reflective is determined. A significant component (around 40%) is the wholesale cost of electricity that is set by spot prices in the NEM and the hedging policies adopted by retailers referred to earlier. The largest component (around 45%) stems from the costs of shipping electricity from its point of generation to the customer along monopoly transmission lines and the poles and wires of monopoly distribution businesses. This cost component is separately regulated and retailers have no ability to control it. The remainder of the final price (or about 15%) is accounted for by retailer's costs such as billing, meter reading and marketing and needs to leave room for a margin. Like other forms of retailing that margin is often quite tight as it is a volume business. The same fundamental pricing principles apply to a retailer whether it is publicly or privately owned.

We say this as some have sought to imply that future prices will be influenced by the ownership of the industry. **Let me reiterate, public or private ownership will have no influence on the level of retail prices in NSW in the future.** Price regulation on the other hand, will have major implications for retailers and for the future of any new generation capacity in the State, especially as the Government has decided to extend retail price regulation until 2013. Whether the industry is publicly or privately owned, this regulation must ensure NSW has cost reflective tariffs if we are to see that new generation materialise.

As a final comment, we would emphasise to the Committee that the issue which will have the greatest implications for future prices is climate change, and in particular, the establishment of the proposed national emissions trading scheme. Once in place this will put a price on greenhouse gas emissions that will provide a signal over time for a major restructuring of the generation sector. It will favour higher cost, lower emission generation technologies. These higher costs will flow through to consumers.

The NSW Government and indeed all Governments in Australia are in favour of the emissions trading scheme as the necessary cost of fighting climate change. The ERAA shares this view but would urge Governments to be open with consumers about what it will mean for the future price of the electricity they consume.

Thank you for the opportunity to make this submission and outline some of the challenges and economic realities confronting energy retailers in Australia.

Yours faithfully,

Cameron O'Reilly  
Executive Director  
Energy Retailers Association of Australia (ERAA)