Australian Energy Market Commission

FINAL REPORT

Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales

3 October 2013

REVIEW

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Final Report

Inquiries

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

E: aemc@aemc.gov.au
T: (02) 8296 7800
F: (02) 8296 7899

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About the AEMC

The Council of Australian Governments (COAG), through its then Ministerial Council on Energy (MCE), established the Australian Energy Market Commission (AEMC) in July 2005. In June 2011, COAG established the Standing Council on Energy and Resources (SCER) to replace the MCE. The AEMC has two main functions. We make and amend the national electricity, gas and energy retail rules, and we conduct independent reviews of the energy markets for the SCER.

Executive Summary

The Australian Energy Market Commission's review of competition in New South Wales (NSW) retail energy markets follows more than a decade of full retail contestability for small energy consumers in NSW.

We have found that competition is delivering discounts and other benefits to small consumers in the NSW retail electricity and natural gas markets. We are confident that competition in NSW is now sufficiently robust to promote choice for consumers and we expect removing retail price regulation for all consumers will lead to more innovation, increased product choice, and competitive pricing.

The Commission recommends a package of measures to enhance consumer choice, including removing retail price regulation, improving information for consumers, maintaining consumer protections, and ongoing market monitoring.

We will also release a supplementary report with recommendations to give consumers information and support to find the best deal for them when choosing an energy retailer or plan. In particular, the supplementary report will provide recommendations on key information and forms of communication needed to support as wide a group of consumers as possible.

Retail energy markets are undergoing significant change

Energy retail markets have undergone a number of changes that have affected both consumers and retailers, and further changes are expected.

Significant increases in network costs and the introduction of state and federal climate change policies ('green schemes') have contributed to higher electricity prices in NSW. Regulated electricity prices in NSW have more than doubled in nominal terms over the past six years, primarily due to increased network costs and government green schemes.[1] Network charges, however, have decreased this year and are projected to moderate over the medium term. Green scheme costs have also stabilised.[2]

Retail price regulation has not protected consumers from these price rises because they relate to increases in the underlying input cost of supplying electricity, faced by all retailers.

While future increases in electricity prices are expected to be lower, retailers, as the interface between consumers and networks, have had to address consumer concerns about their electricity bills.

The nature of the retail operating environment has also been affected by the privatisation of government-owned retail businesses. As a result, retailers have had to

1 IPART, *Review of regulated retail prices and charges for electricity 2013 to 2016, Final Report June 2013*, p. 17.

2 Ibid, p. 10.

compete more actively to attract and to retain customers by providing greater discounts.

A number of new retailers have entered the NSW electricity retail market in recent years, further challenging the incumbents. While there have been fewer entrants in the gas market, three retailers have entered. The incumbent gas and electricity retailers are losing market shares in their areas as a result of competitive pressures.[3]

The introduction of the National Energy Customer Framework represents another change that affects the way retailers engage with consumers. This legislation aims to harmonise consumer protections across jurisdictions and reduce costs for retailers operating in these markets.

Consumers are responding to change by increasing their participation in the market

Consumers are responding to increasing prices by shopping around and taking advantage of the numerous competitive offers available. Consumers have been changing retailers at increasing rates[4] and the number of consumers on regulated tariffs is consistently decreasing.[5]

Many urban and regional electricity consumers can choose from dozens of offers from more than nine retailers. Gas consumers in the Greater Sydney area can choose between four retailers, but gas consumers in some regional areas have more limited options.

The available offers show that the regulated price is not the best price. Substantial discounts are available depending on where a consumer lives, how much energy they consume and how they pay their bills. Electricity retailers have recently offered significant discounts off the usage component of the regulated price, saving an average consumer $300-$400 per year when they pay their energy bills on time.[6] Even when routinely paying their energy bills late, most consumers on market contracts can save money off the regulated rate.[7]

Over 60 per cent of consumers have already chosen a market offer. Last year, 21 per cent of electricity consumers and 14 per cent of gas consumers changed their retailer in search of a better deal.

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3 This is based on data provided by AEMO and recent market analysts' reports.

4 See section 4.4.1 (electricity) and section 5.2.1 (gas) below for more on this point.

5 The most recent IPART retail electricity price determination notes approximately 60 per cent of electricity consumers are now on market contracts, which is up from 35 per cent in 2009/10. See IPART, *Review of regulated retail prices and charges for electricity 2013 to 2016, Final Report June 2013*, p. 28.

6 See St. Vincent de Paul Society, *New South Wales Tariff-Tracking Project*, May Mauseth Johnston, August 2013, p. 6. This range is based on single rate electricity consumers using 7,200kWh per annum. Potential savings will vary according to retailer offer and electricity consumption levels.

7 See section 4.4.3 and Figure 4.8 below.

As a result of increased consumer participation, retailers have responded to the way in which consumers want to engage. Following high complaint levels regarding door knocking practices, all of the large retailers have announced they will cease door knocking.

Supporting increased consumer participation will enhance existing competition

Regulated pricing does not provide benefits to consumers where there is effective competition. Retaining price regulation can lead to prices being higher than necessary or being temporarily set too low, forcing retailers to reduce service or leave the market. Price regulation can also reduce the nature of the choices available to consumers.

Price regulation was removed in Victoria in 2009 and in South Australia earlier this year.

Removing price regulation is unlikely to increase the risk of higher prices. External factors, such as network costs, have largely driven recent energy price increases. We expect the removal of price regulation will lead to greater competition and more innovative and tailored energy plans for consumers.

Removing price regulation would not result in any change to consumer protection regulations that currently apply to all retailers. Importantly, the consumer protections currently in force will remain, such as obligations relating to disconnections, limitations on early termination fees, and government concession schemes.

Maintaining consumer protections is a key part of our recommendations. We also recommend ongoing market monitoring of competition in NSW with the ability to reintroduce price regulation if needed in the future.

We recognise not all consumers are actively considering their energy plan options. Some consumers may not have changed to a market contract because of the difficulty in understanding the benefits available. Others may not have changed their plan because the transaction costs were too high compared to the potential savings. Some consumers may never change to a market contract because their bill is a small proportion of their disposable income and so the incentive to change is low.

However, for those consumers who would like to consider changing their energy plan, it needs to be made easier for them to understand and to compare offers. We will be releasing a supplementary report in October 2013 with recommendations to help consumers access the information they need to choose an energy plan that suits them.

Our recommendations build on the existing strengths of the NSW energy retail markets to progress development for the long term interests of consumers. Empowering consumers to engage confidently in competitive markets is the best protection for consumers.

Our approach to this review

This review was conducted in response to a request from the Standing Council on Energy and Resources (SCER)[8] dated 10 October 2012. Our approach to this review is based on a process set out in the Australian Energy Market Agreement for the AEMC to assess the effectiveness of competition in retail electricity and natural gas markets in Council jurisdictions. The AEMC has conducted similar reviews of Victoria (2008), South Australia (2009), and the Australian Capital Territory (2011).

The Commission considered whether:

- consumers are active in the market;
- there are any barriers to entry, expansion, or exit from the market;
- there is independent rivalry;
- consumers are satisfied with market outcomes; and
- retailers are making profit margins that are consistent with a competitive market.

The Commission found that consumers are active in the market; 21 per cent of electricity consumers and 14 per cent of gas consumers changed their retailer last year.

In the electricity market, we found there are no significant barriers to entry, expansion or exit. In gas, we note there are some barriers to retailers entering the market. However, second-tier retailers have entered this market and are gaining market share.

We found there are indicators of independent rivalry in the electricity market. Even with high market concentration, smaller retailers are winning market share and competition appears intense between the three large retailers.

There are more limited signs of independent rivalry in gas. Compared to electricity, market concentration is high, there is more limited product differentiation, and there are fewer offers, particularly in regional areas.

Surveys indicated consumers of gas and electricity are generally satisfied with their market experiences, but are demanding more transparent information.

Profit margins in gas and electricity appear consistent with a competitive market, with the regulated tariffs in both markets sufficient to support competitive activity. In electricity and gas, new entrants and incumbents are offering discounts off the regulated rates.

In conducting this review, the Commission consulted widely with consumers, consumer organisations, government stakeholders, and energy industry participants. This included conducting consumer and industry workshops, energy consumer

8 Formerly the Ministerial Council on Energy (MCE).

surveys, and publishing an issues paper and Draft Report. We received and considered numerous submissions from various stakeholders to these papers and have drawn upon these submissions in drafting this report.

Summary of findings and recommendations

Assessment of competition in the electricity market (Chapter 4)

1. Competition in the retail electricity market is delivering discounts and other benefits to small electricity consumers through effective choice of their retailer and electricity products.

2. Many urban consumers can choose from up to 50 different offers from 12 different retailers. In regional areas consumers can choose from over 34 offers from 9 retailers.

3. Consumers are increasingly taking advantage of these choices. Around 60 per cent of small NSW electricity consumers have already chosen a market offer, and 21 per cent of consumers switched their retailer in 2012 in pursuit of a better deal.

4. There are no significant barriers to retailers entering, expanding or exiting the retail electricity market.

5. While market concentration is high, smaller retailers are winning market share and competition is intense between the three largest retailers. The incumbent retailers, Origin Energy and EnergyAustralia, both of which purchased the NSW government retail businesses in 2011, have lost significant market share as customers moved to other retailers.

6. The majority of consumers surveyed are generally satisfied with the quality of service they receive. However, these consumers are demanding more transparent and meaningful information that helps them to understand and compare offers.

7. Profit margins are consistent with a competitive market. There is evidence of price-based competition with new and established retailers offering discounts.

8. All retailers offer time-of-use tariffs; however, more work is required to clarify consumer choice and improve understanding of these tariffs. We note the SCER is currently developing its policy on this issue following our recommendations in the Power of Choice report.

Assessment of competition in the gas market (Chapter 5)

9. Competition in the gas market is delivering discounts and other benefits to the majority of small gas consumers through effective choice of their retailer and gas product.

10. Many urban consumers can choose from up to 21 different offers from 4 different retailers. In regional areas there is more limited choice. There is evidence of effective competition in areas serviced by the Jemena distribution network, which includes towns such as Dubbo and Griffith. In a limited number of specific areas, the relatively small size of the customer base and the level of existing tariffs make it difficult for new retailers to enter the market and earn a commercially viable return. These areas include the towns of Wagga Wagga, Tamworth, Albury, and Nowra.

    We consider that removing price regulation for all consumers will improve competition in these areas. However, if the NSW government is concerned about the level of competition outside the Jemena distribution network, the government may wish to consider maintaining voluntary pricing arrangements in these areas until there is evidence of new entry.

11. Consumers are increasingly taking advantage of the available choices. Around 70 per cent of small gas consumers in NSW have already chosen a market offer, and 14 per cent of consumers switched their retailer in 2012 in pursuit of a better deal.

12. New retailers have entered and gained market share. However, there are some barriers to retailers entering the gas market related to the difficulties in accessing gas supply and pipeline capacity with a small customer base.

13. There are limited signs of independent rivalry, with high market concentration and limited product differentiation. There are fewer retailers and offers available than in the electricity market. This likely reflects the nature of domestic gas consumption in NSW – many consumers do not have access to reticulated gas and those that do generally have fairly low consumption.

14. The majority of gas consumers surveyed are generally satisfied with the quality of service they receive. However, consumers are demanding more transparent information, particularly regarding prices.

15. Profit margins are consistent with a competitive market. There is evidence of price-based competition with new and established retailers offering discounts.

Impact of community service obligations on competition (Chapter 6)

16. The NSW community service obligations are clearly specified and transparently funded. Consequently, they are unlikely materially to distort or impede competition.

17. If the NSW government decides to remove retail price regulation, we recommend these community service obligations be reviewed to ensure they are delivering on their intended purposes in an efficient and appropriately targeted manner.

A package of measures to further enhance choice (Chapter 7)

18. The Commission recommends a package of measures be implemented to further enhance choice, including removing price regulation, improving information for consumers, maintaining consumer protections, and ongoing market monitoring.

19. The Commission recommends retail price regulation is removed for all consumers at the same time. Where competition is providing consumers with a choice of energy products at efficient prices, retail price regulation is more likely to inhibit competition than to promote it.

20. We will release a supplementary report in October 2013 with recommendations to give consumers information and support to find the right deal for them and to make it easier for consumers to understand and compare offers.

21. We recommend ongoing market monitoring of competition in NSW with the ability to reintroduce retail price regulation if needed.

Contents

1 Introduction

The Australian Energy Market Commission (AEMC or Commission) has been tasked with reviewing the effectiveness of competition in the New South Wales (NSW) small customer retail markets for electricity and natural gas (the NSW review)[9] and to provide recommendations on removing price regulation and improving the effectiveness of competition.

The NSW retail energy market has undergone a number of changes recently. These changes have affected both retailers and consumers, including a 20 per cent increase in the price of electricity during 2012-2013, due in large part to increased network costs. The nature of the retail operating environment has also been affected by the privatisation of government-owned energy retail businesses, which has resulted in increased competition to attract and retain customers, widespread discounting, and the loss of market share by incumbent retailers to new market entrants.

Furthermore, the Independent Pricing and Regulatory Tribunal (IPART) has recently completed its review of regulated retail prices for the 2013-2016 period. As a result of this review, IPART's final report set out average electricity price increases of 1.7 per cent for 2013-2014 and average gas price increases of 8.5 per cent.[10] The regulated electricity price increase for this determination was substantially lower than those in recent years, largely due to decreased network costs and relatively stable green scheme costs projected over the period.

Regulated prices represent a cap on the prices that retailers can charge. We note that while these tariffs are intended to remain in place until 30 June 2016 the NSW government may remove retail price regulation at any time.

1.1 Request for advice

The Commission received the request for advice from the Standing Committee on Energy and Resources (SCER) on 10 October 2012.[11] The request for advice also included a statement of approach, which laid out the methodology for assessing retail competition and the required scope of the review. This review was required to be completed and submitted to the NSW government and the SCER by 30 September 2013.

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9 For the purposes of this report, small customers are defined as electricity users who use less than 160 megawatt hours (MWh) per annum and gas users who consume less than 1 terajoule (TJ) per annum. The definition of a small electricity consumer for the purpose of retail price regulation has recently changed in NSW and is now defined as those consumers who use less than 100 MWh per annum.

10 IPART, *Review of regulated retail prices and charges for electricity 2013 to 2016, Final Report June 2013*, p. 2.

11 This notification was issued in a letter from the Chair of the SCER, the Hon. Martin Ferguson AM MP, to the Chairman of the AEMC, John Pierce, 10 October 2012. Available on our website at www.aemc.gov.au.

The Commission was requested to provide advice on:

- the state of competition and the extent to which it is deemed effective for small electricity and small natural gas consumers;
- the availability and take up of time-of-use tariffs and the impact of time-of-use tariffs on competition; and
- based on that assessment, advise on ways in which the effectiveness of competition can be improved (where competition is found not to be effective) as well as possible implementation strategies for the removal of retail price regulation for small electricity consumers and small natural gas consumers in NSW, regardless of the state of competition. This is to include advice for an option to gradually roll back retail price regulation by reducing the eligible consumption threshold.

1.2 This report

This report addresses the request for advice and draws upon the Draft Report for this review, including the appendices and stakeholder submissions. To complement this report, we are preparing a supplementary report that is focussed on improving consumers' understanding of their choices in the retail energy market.

The remainder of this report is structured as follows:

- chapter 2 sets out the assessment framework we have applied;
- chapter 3 describes the market definition used for this review;
- chapter 4 provides our assessment of competition in the electricity market, including time-of-use tariffs;
- chapter 5 provides our assessment of competition in the gas market;
- chapter 6 evaluates the impacts of community service obligations on competition; and
- chapter 7 sets out recommended measures to further enhance competition.

1.3 Sources of information the Commission has drawn upon

The Commission initiated this review on 13 December 2012 by releasing an issues paper for stakeholder comment concerning their experience of competition in NSW's small consumer electricity and natural gas retail markets. In response, the AEMC received 17 submissions from consumer groups, retailers, industry associations, a gas distribution business, and an energy consultancy.

After publication of the Draft Report on 23 May 2013, the AEMC received 19 submissions from consumer groups, retailers, industry associations, a gas distribution business, and state and federal government organisations. The Commission has drawn from these submissions in developing its findings and recommendations.

To inform our considerations and to provide additional analysis for this review, the AEMC engaged Roy Morgan, Sapere Research Group, NERA Economic Consulting, and Newgate Research.[12]

Professor George Yarrow of the Regulatory Policy Institute peer reviewed the Draft Report.

1.4 Relevant strategic priority

This review furthers the AEMC's proposed new strategic priority relating to strengthening consumer participation while continuing to promote competitive retail markets. The recommendations in this report will further promote competition in NSW retail electricity and gas markets.

Together with the supplementary report that will be published in October 2013, the recommendations will also support greater consumer participation in retail energy markets.

12 These consultant reports are available, or will be available, on the AEMC website.

2 Assessment framework

This chapter summarises the analytical framework that underpins the Commission's assessment of the effectiveness of competition in the retail energy markets.

2.1 What does effective competition mean for consumers?

Effective competition is characterised by how well the market process promotes the long term interest of consumers. This may be summarised as:

- prices that trend to efficient costs over time;
- quality of service that matches consumers' expectations; and
- choice of products and services consistent with consumers' preferences.

2.2 How do we measure effective competition?

Effective competition requires effective participation of both the demand and supply side of the market - that is, consumers and retailers. Our assessment considered whether consumers are aware, informed and engaged, and whether retailers are motivated to provide the products consumers want at prices reflecting the efficient costs of providing them.

There is no single measure of competition. Rather, we have examined a number of different indicators that together have informed our conclusions. Accordingly, the Commission has been guided by the market characteristics most likely to provide outcomes consistent with those in effectively competitive markets.

Markets are dynamic; conditions change as the cost of inputs and technologies change, demand levels vary, and firms enter and exit the market. It is therefore important for any assessment of competition to examine a period, rather than a snapshot of competition. As part of this assessment, we considered the likelihood of any major changes in market conditions that could impact the level of competition.

The purpose of this assessment is to determine whether competition is sufficiently effective such that price regulation is no longer required.

2.2.1 Our approach

Under the terms of the Australian Energy Market Agreement (AEMA), the AEMC is to base its assessment of the effectiveness of competition on criteria that were developed by the Ministerial Council on Energy (MCE) through public consultation.[13]

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13 Notice of amendment to the Australian Energy Market Agreement, 2 October 2011.

These MCE criteria are:

- consumer switching behaviour;
- ability of suppliers to enter the market;
- independent rivalry within the market;
- differentiated products and services;
- price and profit margins; and
- the exercise of market choice by consumers.

For this review we have drawn on these criteria and refined them to focus our assessment on whether the NSW retail market is providing outcomes consistent with effective competition. In sum, we have considered whether:

- *consumers are active in the market* - incorporating the first and sixth criteria. The desirable outcome of a competitive market is that consumers are aware of the choices available to them, are able to act on those choices, and that consumer behaviour is consistent with a competitive market;
- *there are any barriers to retailers entering, expanding or exiting the market* - this expands upon the second criterion to consider whether existing retailers can expand or exit in addition to consideration of whether new retailers can enter the market;
- *there is independent rivalry, such that retailers are competing strongly with each other to attract and retain customers* - this combines the third and fourth criteria because evidence of differentiated products and services is a sign that retailers are competing to attract customers;
- *customers are satisfied with outcomes in the market* - this is additional to the criteria. It is an important consideration on its own merits as well as being useful to understanding consumer behaviour; and
- *retailers are making profit margins consistent with a competitive market* - the fifth criterion.

Together, these are referred to as the "competitive market indicators" (or "indicators").

Any competition assessment requires a definition of the market to set the boundaries of the products and services that are relevant to the review. This definition of the market for the purposes of this review is set out in the next chapter.

3 Market definition

Box 3.1: Summary of chapter

The Commission considers the relevant markets for assessment are:

- the retail supply of electricity to small consumers in NSW; and
- the retail supply of gas to small consumers in NSW.

There is a market for the retail supply of electricity and a market for the retail supply of gas:

- while some appliances can be powered by gas, many require electricity, such as lighting, cooling and refrigeration; gas, therefore, is an imperfect substitute for electricity;
- while they may be presented together, retailers offer separate electricity and gas products and there are currently no financial benefits to purchasing these products together; and
- there is a degree of substitutability from gas to electricity in the longer term; however, in the shorter term substitution may be prohibitively expensive.

There is a single market for small business and residential consumers:

- the majority of retailers market to both small businesses and residential consumers;
- the legislative requirements to supply these consumers are the same; and
- the levels of awareness of ability to choose a retailer are similar across residential and small business consumers.

NSW is the geographic scope of the relevant markets:

- consumers cannot access retail offers available in other states;
- consumer awareness of the ability to choose a retailer is high and discounts are similar across NSW; and
- most retailers in NSW operate state-wide.

Part of determining whether competition is effective requires assessing whether customers are able to change from one service to another service if prices become high or if service quality becomes unacceptable. Where competition is not effective, retailers may increase prices and/or reduce product or service quality without risk of losing customers. In contrast, where competition is effective, retailers must strive to lower prices and improve services to acquire and retain customers.

The terms of reference require the Commission to assess whether competition is effective for small electricity and natural gas consumers in NSW.[14] To carry out that assessment, we need to know whether the supply of electricity and gas to small consumers in NSW is a single market, is part of a larger market, or consists of a number of markets.

The assessment draws on the framework used by the Australian Competition and Consumer Commission (ACCC). The key to market definition is viable product or service substitution; that is, the extent to which "goods or services are substitutable for, or otherwise competitive with, the goods or services under analysis."[15] In broad terms, this requires answering the following questions:

- What alternatives are available to consumers when making decisions about gas and electricity consumption?
- Are there retailers or potential new entrants that could quickly enter the market to supply dissatisfied customers?
- Are there groups of consumers, such as regional consumers, for whom the answers to these questions differ?

It is important to recognise the context of this analysis of market definition - ie, a review of the effectiveness of competition - and to understand that market definition is not an end in itself. Market definition simply provides a useful framework for competition analysis and may not feature in or affect later policy decisions.

3.1 Product dimension

The product dimension considers the product(s) or service(s) that should be considered as within the same market. It does so by considering the products to which consumers could change if prices of the product in question rise and whether retailers of alternative products can easily start supplying the relevant product.

3.1.1 Findings from our Draft Report

In our Draft Report we found there are no other close substitutes for natural gas or electricity that may constitute the same market. We therefore concluded that the relevant markets for this review are limited to natural gas or electricity. We noted that

14 Defined by consumption threshold in the National Energy Retail Law (Adoption) Regulation 2013.

15 ACCC, *Merger guidelines*, November 2008, p. 15.

bottled liquefied petroleum gas (LPG) could be considered an alternative to gas supplied through the reticulated gas network. However, while it is feasible that consumers with a natural gas connection could use LPG as an alternative, the cost difference and inconvenience is such that it is unlikely to be seen as a substitute by the majority of consumers.

The Commission's draft finding was that there are two product markets for electricity and natural gas in NSW: an electricity market and a dual fuel market.[16] We further considered the retail supply of electricity and the retail supply of dual fuel as distinct from other stages of the supply chain.[17]

This finding reflected our observations of how the electricity and gas markets operate in practice, namely:

- consumers face different choices depending on whether they are connected to gas and electricity or solely electricity. For customers with a connection to both fuels, there is more scope to choose between gas and electricity for the provision of many services and more options when choosing an energy retailer;
- there is a degree of substitutability from gas to electricity for both consumers and retailers; and
- the majority of dual fuel consumers have their gas and electricity accounts with the same provider.

3.1.2 Submissions

The majority of submissions to the Draft Report did not comment on the proposed market definition. Origin Energy and EnergyAustralia supported the definition.[18]

The Public Interest Advocacy Centre (PIAC) disagreed with the AEMC's classification of residential gas consumers being part of a dual fuel market. In its submission, PIAC argued the high costs associated with changing appliances from gas to electricity undermines the feasibility of gas acting as a substitution for electricity, particularly for consumers living in rental properties.

PIAC also argued that consumers who do not buy a dual fuel product (that is, do not purchase their gas and electricity from the same retailer) cannot be considered part of the dual fuel market.

3.1.3 Conclusions on product dimension

The Commission has further considered its position on the product dimension and has concluded that there are two separate markets: a market for the retail supply of

16 See chapter 3 of the Draft Report for discussion of how we reached this draft conclusion.

17 Such as the generation/production or transportation of electricity and gas.

18 Origin Energy, Draft Report submission, p. 7; EnergyAustralia, Draft Report submission, p. 3.

electricity and a market for the retail supply of gas. Our reasons for this conclusion are set out below.

We continue to consider that the relevant markets for this review are limited to natural gas or electricity and that the retail supply of electricity and the retail supply of gas are distinct from other stages of the supply chain, such as generation and transport.

Electricity

Electricity is generally accepted to be an essential service for modern living and is required for the services it provides (such as lighting, cooling, refrigeration, etc), rather than direct consumption. Many of these services cannot be enjoyed without electricity.

Natural gas can be used to provide some of the services provided by electricity, in particular heating and cooking. Therefore, consumers can potentially change to gas from electricity for some services. However, other services, such as lighting and most appliances, require electricity.

Some NSW households may not have access to natural gas because there is limited penetration of gas infrastructure. The take-up of gas is also discretionary. We note approximately 57 per cent of NSW residential consumers are not currently connected to mains gas infrastructure.[19] For these consumers, using gas instead of electricity is not an option, too costly, or infeasible. Gas does not act as an effective substitute for these consumers. Therefore, we consider there is a separate market for electricity.

Gas

We noted in our Draft Report that all NSW gas retailers also supply electricity - that is, there are no "gas only" retailers in NSW - suggesting there are business synergies in retailing both energy sources. However, we also note all retailers that offer gas also sell a separate gas product, not just a dual fuel product.

Further, in a change since the Draft Report was published, it appears retailers are not presently offering a dual fuel product that provides additional discounts or any other differences to their separate electricity and gas products. We note approximately one third of consumers in NSW have their electricity and gas supplied by different retailers.

In our Draft Report we noted that all services provided by gas can also be provided by electricity. Although the quality of the service may not be identical, customers do have a choice.

Conversely, it is not a realistic proposition to use gas for a large number of the services provided by electricity, as discussed above. That is, consumers can change from gas to electricity for all services provided by gas, whereas changing from electricity to gas is only possible for a subset of services.

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19 Derived from Jemena, Issues Paper submission, 8 February 2013, p. 2.

Having further considered PIAC's submission, we agree that in the short term it may be difficult for some gas consumers, such as people who live in rental properties, to change to electricity. Further, some products may be very expensive to convert to an alternative fuel source, such as hot water and cooking. Consequently, there may not be a sufficient number of people who are able to shift a material proportion of their consumption to prevent a retailer from raising gas prices to inefficiently high levels.

In the longer term, however, we consider that there is a greater degree of substitutability from gas to electricity. If there was a significant increase in the price of gas relative to electricity, consumers would eventually change away from gas. For example, new housing developments may be less likely to connect to the gas distribution network and appliances may be replaced over time. Therefore, in the longer term, the ability to substitute from gas to electricity provides some competitive constraint on gas retailers.

As we noted in the Draft Report, the energy retail sector displays some characteristics of a dual fuel market, such as an increasing number of consumers who choose to be supplied by the same retailer for both fuels. However, we agree with PIAC that the costs of changing appliances are likely to be high enough for a sufficient number of consumers that the retail supply of gas constitutes a separate market to the retail supply of electricity.

For these reasons, the Commission considers that there is a separate retail market for the supply of gas. While this affects to some extent the way we present and analyse the evidence on competition in comparison with the Draft Report, it has not impacted our policy conclusion.

3.2 Consumer dimension

There is less available information to assess differences between small business and residential consumers. Consequently, the evidence is less conclusive as to whether small business and residential consumers are in the same or separate markets.

In the Draft Report, the Commission considered the available evidence pointed towards a single market for small businesses consumers and residential consumers.[20] We found that the majority of retailers market both to small businesses and residential consumers. Similarly, the levels of awareness of ability to choose a retailer were similar across residential and business consumers.

Moreover, the legislative requirements for supplying small businesses and residential consumers are the same. The regulated electricity tariff is also available to all small consumers in NSW, including residential consumers and small business consumers whose consumption is below a certain threshold.

Only those businesses that consume less than 160MWh per annum are considered part of the electricity market, as per our Request for Advice. This is because, at the time the

20 For further analysis on this point, see section 3.2.4 of the Draft Report.

Request for Advice was provided, businesses that consumed greater than this amount were not eligible to be on a regulated tariff. This threshold was reduced to 100MWh per annum as of 1 July 2013.

No submissions to the Draft Report addressed this conclusion and we have received no further evidence to suggest that small business and residential consumers are part of separate markets. For these reasons, the Commission confirms its draft conclusion that small business and residential consumers are part of a single market.

3.3 Geographic dimension

The geographic dimension of market definition refers to the physical area or areas over which the relevant product or products are supplied and over which consumers can practically access the product(s). This considers whether consumers can easily switch their consumption to an alternative geographic area. On the supply side it examines whether suppliers in other areas could easily supply the relevant area.

In the Draft Report the Commission noted that retail markets across the NEM are highly related and that a greater emphasis in nationally consistent approaches to supplying both gas and electricity may eventually lead to a single market for each energy source. However, these processes are not sufficiently progressed for the NEM or east coast gas markets to be presently considered as single markets.

Geographic substitution is also limited because NSW consumers are not able to obtain supply from retailers that operate in other states (but not NSW) and retail offers are specific to consumers in a particular state.

There is also a greater level of risk in purchasing electricity on the wholesale market from generators in other states, as the risk of network constraints affecting the ability to transport electricity is higher when that electricity has to be transmitted between states than if it is purchased and consumed within the same state.

The Commission also considered whether there was more than one market within NSW. For electricity, we considered whether geographic markets should be defined by the three distribution network areas,[21] which can be described as:

- Ausgrid: Inner, northern and eastern metropolitan Sydney and surrounds. Approximately 1.6 million customers over 22,275 km^2;
- Endeavour Energy: Southern and western metropolitan Sydney and surrounds. Approximately 0.9 million customers over 24,500 km^2; and
- Essential Energy: Country and regional NSW. Approximately 0.8 million customers over 582,000 km^2.

21 We note the three distribution businesses are now being merged under a single corporate structure: Networks NSW. It is convenient to refer to the three distribution companies to consider possible geographic differences.

The Commission considered the evidence available indicates the competitive conditions across the three distribution areas are sufficiently similar such that they should not be treated as separate geographic markets for the purposes of assessing competition. Most retailers in NSW operate in all three areas, consumer awareness of the ability to choose a retailer is high in each area, and discounts across the three are similar. As depicted in Figure 4.2 below, switching rates are also high in all areas.

In respect of gas, the Commission has also found that there is a single, NSW-wide market. While there is currently a single retailer operating in parts of regional NSW, if prices were to rise above cost-reflective levels, new retailers can be expected to enter the market to compete to supply these consumers and take advantage of higher prices. In doing so, competition would increase and prices should be competed down to cost-reflective levels.

All major gas distribution pipelines are currently covered by access regulation under the National Gas Law, which regulates the terms and conditions under which retailers access these networks. While we have found that there are some barriers to entering the NSW gas market,[22] once a retailer is operating in the NSW market there appear to be low barriers to expanding their operation.

No submissions to the Draft Report addressed our draft conclusion on the geographic scope of the markets and we have received no further evidence to suggest the markets are wider or narrower than NSW. For these reasons, the Commission confirms its draft conclusion that there is a single market for both electricity and gas across NSW.

3.4 Conclusion

The Commission considers that an assessment of competition for small consumers in NSW should be carried out on the basis of two separate product markets:

- a market for the retail supply of electricity for small consumers; and
- a market for the retail supply of gas for small consumers.

In summary, the reasons for this are:

- while some appliances can be powered by gas, many require electricity, such as lighting, cooling and refrigeration; gas is, therefore, an imperfect substitute for electricity;
- there is a degree of substitutability from gas to electricity in the longer term; however, in the shorter term substitution may be prohibitively expensive; and
- while they may be presented together, retailers do offer separate electricity and gas products.

22 See section 5.2.2 below for more on this point.

The evidence is less conclusive as to whether small business consumers and residential consumers are in the same or separate markets. However, on balance, the Commission finds the available evidence indicates these consumers are in the same market.

The Commission considers the geographic scope of the relevant market is NSW, for both electricity and gas. We find there are sufficient differences between the states and the costs of entering the NSW retail markets such that they should not be defined more broadly than NSW.

We also find the costs and conditions of operating a retail business are sufficiently similar across NSW such that there is a single geographic market for both electricity and gas for the purposes of this review.

4 Assessment of competition in the electricity market

Box 4.1: Summary of chapter

The Commission concludes competition in the retail electricity market is effective and providing benefits to small consumers. This conclusion is based on the following findings:

1. Consumers are active in the market: 21 per cent of consumers changed their electricity retailer last year, primarily to obtain a better price. This number has remained steady in 2013. Over 60 per cent of consumers are already on a market contract. However, consumers need better information and support to choose an offer that is best suited for their circumstances.

2. There are no significant barriers to retailers entering, expanding or exiting the market: retailers are able to source electricity, manage spot price risk, and access economies of scale through outsourcing their billing systems.

3. There are indicators of independent rivalry: while market concentration is high, smaller retailers are winning market share and competition appears intense between the three largest retailers. Consumers can choose from a range of products and retailers are offering discounts.

Outcomes in the market are consistent with effective competition:

4. A majority of consumers surveyed are generally satisfied with their market experience, but are demanding more transparent information.

5. Profit margins are consistent with a competitive market: the regulated tariff has sufficient headroom to support competitive activity. New retailers are offering discounts and incumbents are responding to this competition.

All retailers offer time-of-use tariffs; however, more work is required to clarify consumer choice and improve understanding of these tariffs.

4.1 Introduction

This chapter assesses whether the electricity market is effectively delivering efficient outcomes for small consumers. The Commission has considered whether:

- consumers are active in the market;
- there are any barriers to retailers entering, expanding or exiting the market;
- there is independent rivalry;
- consumers are satisfied with outcomes in the market; and

- retailers are making profit margins consistent with a competitive market.

As required by our Request for Advice, we have also considered the availability and take-up of time-of-use tariffs and the implications for competition.

This chapter is structured as follows:

- section 4.2 summarises the findings from the Draft Report;
- section 4.3 summarises submissions to the Draft Report;
- section 4.4 provides further analysis undertaken since the Draft Report was published, including responses to submissions; and
- section 4.5 provides our final conclusions.

Box 4.2 below describes how retail electricity and gas prices for small consumers in NSW are currently regulated.

Box 4.2: NSW energy retail market price regulation

All retailers today can decide what prices they will charge their customers. These prices are known as "market offers".

However, some retailers are required to offer a tariff that is set by the NSW regulator, IPART. This requirement was put in place when full retail contestability was introduced while competition was still developing.

Following their purchase of the previously government-owned retailers, Origin Energy and EnergyAustralia are required to offer a regulated electricity tariff in their allocated districts. Similarly, AGL, Origin Energy and ActewAGL are required to offer a regulated gas tariff in their allocated districts.[23]

All energy retailers, including those referred to above, can, and do, offer other prices to customers who choose to enter into a market contract.[24] Customers may also move from a market offer back to the regulated rate. No other retailer is required to offer the regulated rate to customers.

The regulated price is not the cheapest price. In practice, almost all market offers are currently lower than the regulated rate.

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23 For an explanation of allocated districts, see National Energy Retail Law (Adoption) Regulation 2013, Part 2, cl. 6.

24 Some gas retailers, such as ActewAGL, currently only offer the regulated tariff in their allocated district.

4.2 Findings from the Draft Report

4.2.1 Consumers are active in the market

Consumer participation in the market is an important measure of whether competition is effective. Without consumers actively searching for better offers, retailers could raise prices and lower service quality without losing customers. By searching for better deals and changing to retailers that have lower prices or provide better service, consumers play an important role in maintaining downward pressure on prices and driving retailers to provide the quality of service consumers demand.

Awareness is high

Surveys conducted on behalf of the AEMC demonstrate awareness of the ability to change retailers is high: around 90 per cent of small consumers are aware they can choose their electricity retailer.[25] A number of recent events have contributed to this high level of awareness:

- privatisation of the NSW government-owned retailers: contributed to greater consumer awareness and positively affected competition;
- the One Big Switch campaign: invited consumers to sign on to its initiative to negotiate bulk power discounts; and
- price rises: significant price increases over the past two years have encouraged consumers to shop around the competitive market for better deals.

Consumers are switching

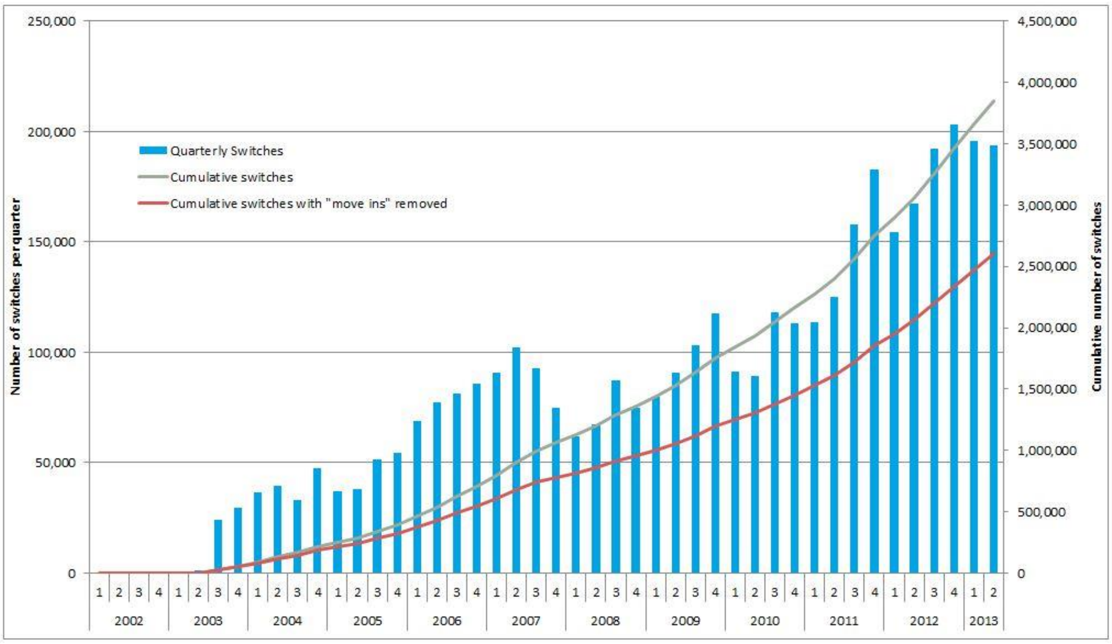
Consumers are increasingly exercising their ability to choose their retailer, as demonstrated in the chart below. The upward trend in switching rates is broadly consistent across all three network areas.

In 2012, 21 per cent of consumers switched their electricity retailer. This compares to 26 per cent in Victoria and 23 per cent in South Australia over the same period. In the first six months of 2013, this trend has continued with annualised switching rates of approximately 20 per cent each month.[26]

25 Roy Morgan, *Survey of Residential Customers of Electricity and Natural Gas in New South Wales: Effectiveness of Retail Competition*, 28 February 2013, p. 9.

26 AEMO, NEM Monthly Retail Transfer Statistics for January to July 2013. Available at www.aemo.com.au.

Figure 4.1 Quarterly switching from 2002 to July 2013



Source: Data provided by AEMO.

Surveys suggest consumers switch primarily to obtain a lower rate. Approximately 69 per cent of residential consumers[27] and 82 per cent of small business consumers[28] surveyed reported switching either to obtain a better price or other financial benefit.

While the majority of switching is between the "big three" retailers (Origin Energy, AGL and EnergyAustralia), more consumers are switching to smaller retailers than are switching back from smaller retailers towards the big three.[29]

Concerns were raised in response to the Issues Paper about awareness of retail competition and switching rates in Essential Energy's network area. While there is some evidence to suggest consumers have previously been less active in this area, increases in switching rates in this network area indicates these consumers are becoming more active as demonstrated in Figure 4.2 below.

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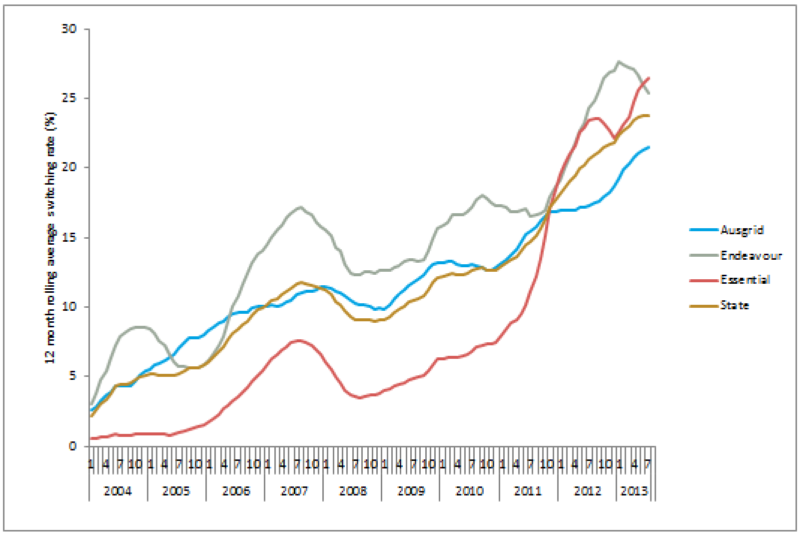
27 Roy Morgan, *Survey of Residential Customers of Electricity and Natural Gas in New South Wales: Effectiveness of Retail Competition*, 28 February 2013, p. 24.

28 Roy Morgan, *Survey of Business Customers of Electricity and Natural Gas in New South Wales: Effectiveness of Retail Competition*, 28 February 2013, p. 25.

29 See chart at Figure 4.4 below.

Figure 4.2 Switching rates by distribution network



Source: Data provided by AEMO.

Some consumers remain on regulated tariffs

The IPART notes approximately 40 per cent of consumers remain on regulated tariffs.[30] These consumers have either chosen to remain on the regulated rate or have simply decided, for a multitude of reasons, not to change to a market tariff. These consumers may not be capturing the full benefits of competition.

In the Draft Report we considered reasons for this may relate to:

- the complexity of available information;
- a belief that the regulated price is reasonable; and
- consumer inertia.

We also consider that the transaction costs and inconvenience associated with switching retailers may be too great for some consumers. The time and research required to locate and identify quality information needed to make an informed decision about changing their energy plan may outweigh the likely savings for some consumers. These consumers may rarely, if ever, switch their retail energy providers.

There will likely always be a segment of consumers for whom looking for a better deal and switching retailers is not a high priority.

The AEMC is primarily concerned with ensuring those consumers who would like to switch retailers or change their energy plan understand that they can and are able to access the right information to choose an energy plan that suits their needs. While

30 IPART, *Review of regulated retail prices and charges for electricity 2013 to 2016, Final Report June 2013*, p. 15.

some proportion of consumers may never switch retailers, this should be an informed decision.

Analysis of the reasons why consumers may not switch retailers was undertaken for the Draft Report. We have since undertaken further analysis of barriers to consumers changing their energy plans and retailers, including qualitative and quantitative analysis, which will be presented with our supplementary report to be published later this year.

Information provision needs to be improved

To participate effectively in the market, consumers need to have the right information and tools to make the best choice for them. Unless the information they need is easy to obtain and understand, is relevant, up-to-date and allows competing energy offers to be compared, consumers may not obtain the full benefits of competition.

While many consumers are switching, surveys commissioned by the AEMC reveal many consumers find the information provided by retailers to be difficult to understand and unhelpful for choosing an offer. A number of residential consumers who had not switched cited reasons related to information quality and concerns about the switching process:[31]

- 25 per cent could not be bothered switching or thought it was too much effort;
- 16 per cent thought the information was too complex or too technical;
- 13 per cent found there was insufficient information;
- 11 per cent were concerned about the switching process; and
- 9 per cent could not understand the information, found it vague, poorly written or poorly organised.

The results from small businesses were approximately five per cent higher in most of these categories; 21 per cent of small business consumers surveyed were concerned about the switching process.

Some consumer groups raised concerns that a lack of useful information and a proliferation of tariffs with multiple variables is either preventing consumers from participating in the market or resulting in poor choices being made by consumers.[32]

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31 Roy Morgan, *Survey of Residential Customers of Electricity and Natural Gas in New South Wales: Effectiveness of Retail Competition*, 28 February 2013, p. 22. Note respondents could provide multiple reasons for not switching.

32 CHOICE, Issues Paper submission, 8 February 2013, p. 6. Also see Consumer Utilities Advocacy Centre, *Improving energy market competition through consumer participation*, December 2011.

4.2.2 Retailers can enter, expand and exit the market

Barriers to entry, expansion and exit are important elements of a competition assessment. Where retailers can freely enter and exit the market, there are competitive pressures on incumbent firms to charge prices commensurate with their costs.

Historically, there have been a number of impediments to competition flourishing in the NSW electricity retail market. However, many of these impediments have been, or are currently being, phased out, including the Electricity Tariff and Equalisation Fund (ETEF) and obsolete tariffs.[33]

Whilst the ETEF scheme has closed, there remain a number of historical regulated tariffs in the Essential Energy network area that are no longer available to new customers, but remain for some existing customers. We noted in the Draft Report that obsolete, non-cost reflective tariffs make it difficult for other retailers to compete and may act as a barrier to entry.

There are a number of other regulatory and non-regulatory costs and impediments that could impose a barrier to entry and inhibit new retailers from entering the market. The Commission has considered each of these in turn and concluded that there are no significant barriers to entry, expansion or exit.

New entrant retailers are able to source electricity and manage wholesale spot price risk through financial hedging products.[34] A number of new entrants are backed by generation companies and have access to physical hedges.[35]

For those firms without physical hedges, the contracting market is liquid and 55 per cent of generation capacity in NSW is currently controlled by state-owned corporations (not other retailers), suggesting there are no barriers to obtaining hedges at reasonable prices. However, we note the sale of NSW generation assets may change the market structure and potentially make it more difficult for smaller retailers to obtain hedges.

Economies of scale exist in electricity retailing where the average cost of serving a customer declines as the size of the customer base increases, since a larger customer base allows a retailer to spread its fixed costs across a greater number of customers. Consequently, incumbent retailers with large legacy customer bases may have an advantage over smaller, new entrants whose costs per customer may be much higher.

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33 The Electricity Tariff and Equalisation Fund provided government-owned retailers with a means to smooth wholesale electricity risk by requiring them to pay into a fund when wholesale prices were low and allowing them to draw from the fund when wholesale prices were high. Other retailers did not have access to this fund and consequently had relatively higher hedging costs. This scheme closed in mid-2011.

34 Retailers are able to source electricity from the electricity wholesale market, which operates as a "gross pool"; all electricity generated and consumed is traded through this market. However, electricity spot market prices are very volatile; to enter the market retailers must have access to products that allow them to hedge the risks associated with purchasing from the wholesale market.

35 For example, Momentum Energy is backed by Hydro Tasmania, Simply Energy is backed by GDF SUEZ Australian Energy, and Red Energy is backed by Snowy Hydro.

However, new entrants can outsource many services, such as billing, and so capture economies of scale.

Economies of scope may exist where a retailer that can spread its fixed costs over more than one product (eg, electricity and gas) has an advantage over retailers that only offer one product. These retailers can leverage off a single marketing channel, reducing their costs. Further, customers that have more than one product with a single retailer may be "stickier" and less likely to switch.

As discussed further in the next chapter, gas consumption is relatively low in NSW. Consequently, while there may be some economies of scope, these are not likely to prevent electricity only retailers from competing.

Exit costs may arise where substantial upfront investment is required to enter the market and this investment cannot be recouped on exit. Exit barriers may also exist where contractual arrangements impede exit. The Commission found there are no substantial exit costs in electricity retailing.

The market operator and network businesses place credit support requirements on retailers to support electricity purchases and the cost of transport across networks to small consumers.[36] The cost of credit support can be high and cash-intensive. However, these costs are not a barrier to entry or expansion because they are scalable - that is, these costs are relatively low for smaller firms and increase as they grow.

Retailers cited a number of state-based regulatory requirements that increase the cost and complexity of operating in the electricity retail market, including environmental and green schemes. State-based regulations can be costly, particularly where they differ across jurisdictions. However, these costs do not appear to be preventing retailers from entering or expanding in the market.

A number of retailers suggested the greatest barrier to entering the NSW electricity market was the continuation of retail price regulation.[37] Price regulation can create regulatory uncertainty, which can reduce a retailer's capacity and willingness to enter and/or expand in the market, partly because it can make it more difficult or costly to access finance.

The apparent use of Victoria as a springboard into energy retailing in NSW suggests there are some barriers to entry in the NSW market compared to the Victorian market, where retail price regulation ended in 2009. However, a number of new retailers have entered the NSW market in the last few years, including the entry of Click Energy as recently as March 2013.

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36 We note the network credit arrangements for retailers will eventually be governed by the NECF, which adopts a different approach to the existing arrangements.

37 See Sapere Research Group, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales - Report of Interviews with Energy Retailers*, February 2013, pp. 35-38.

4.2.3 There is evidence of independent rivalry

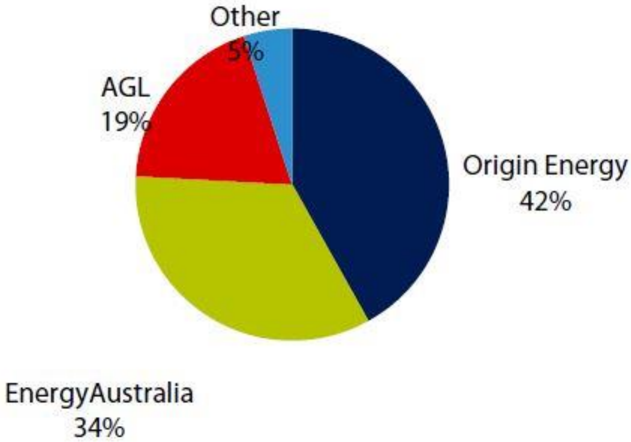
The extent to which retailers are competing to attract or retain customers is an indicator of the state of competition in the market. Rivalrous behaviour can be measured by, for example, the number of retailers participating in the market; market share and concentration of the market; innovation in service and product offerings; and aggressiveness or defensiveness of marketing strategies.

Market concentration is high and product differentiation is not as wide as in Victoria, but other factors - such as switching between retailers and marketing expenditure - suggest there is a sufficient level of independent rivalry to support competition.

Market structure

There are currently 12[38] retailers competing for small consumers across NSW.[39] Six of these retailers supply electricity to both residential consumers and small business consumers. Four retailers focus on residential customers, while the remaining two focus on small business.[40]

Figure 4.3 Electricity market share (June 2012)



Source: IPART, *Review of regulated retail prices and charges for electricity 2013 to 2016: Issues Paper*, November 2012, p. 25.

Market concentration is high: AGL, EnergyAustralia, and Origin Energy together have a 95 per cent market share. This represents an increase in market concentration since privatisation. Market concentration, as measured by the Herfindahl–Hirschman Index

38 Subject to the proposed takeover of AP&G by AGL. We note the ACCC indicated on 12 September 2013 that it will not oppose the proposed acquisition by AGL of AP&G.

39 Note ActewAGL and AGL both supply electricity, but do not compete in the same area.

40 Sapere Research Group, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales - Report of Interviews with Energy Retailers*, February 2013, p. 5. Note Click Energy entered the NSW market after these interviews were conducted.

(HHI), is even higher when assessed by network area because the standard retailer controls a larger proportion of the market.[41]

The standard retailer for each electricity distribution region along with the approximate HHI in each distribution region is as follows:

- EnergyAustralia (Ausgrid distribution region) 4,300
- Origin Energy (Endeavour distribution region) 4,100
- Origin Energy (Essential distribution region) 6,100

High market concentration is not necessarily a sign of a lack of effective competition. Consumers are switching between retailers. Incumbent retailers are losing market share and offering discounts, including within their own regions.[42]

While the majority of switching occurs between the big three retailers, smaller retailers are capturing market share. Since privatisation, more consumers are switching to small retailers from the big three than away from them; see below Figure 4.4. For example, AP&G gained over 10,000 electricity customers in the six months to 31 December 2012.[43] Origin lost approximately 43,000 electricity customers over the same period.[44]

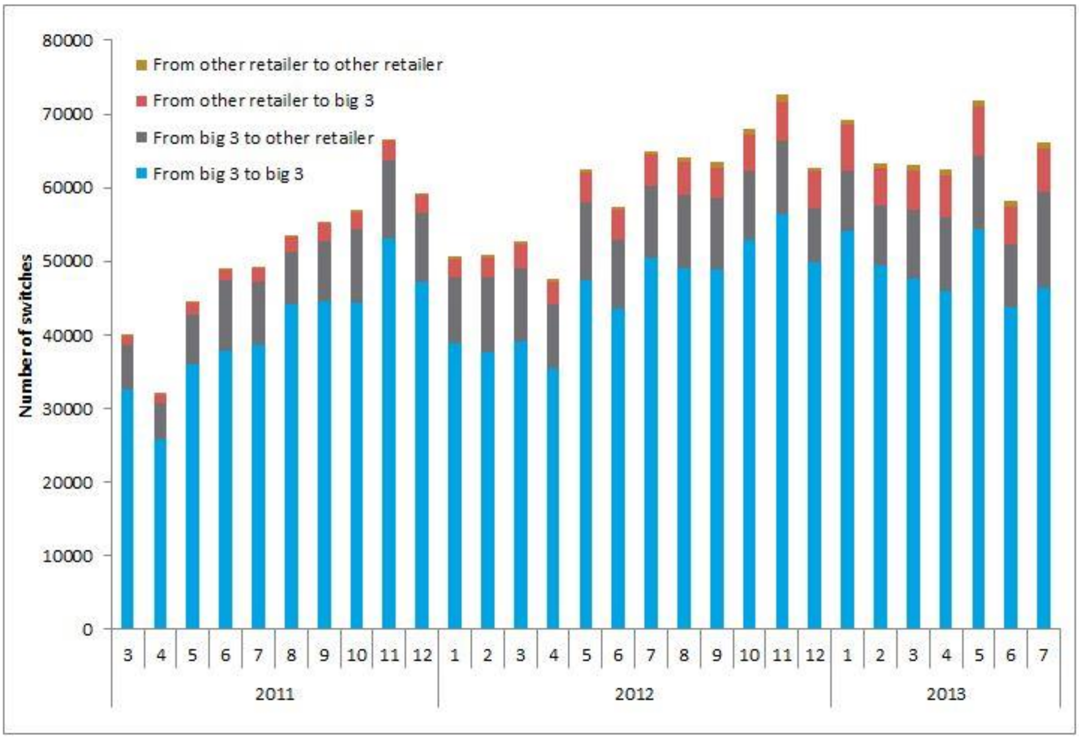
41 The ACCC uses a score of 2,000 as a threshold when considering the level of competition when assessing mergers. See ACCC, *Merger guidelines*, November 2008, p. 37.

42 For example, EnergyAustralia, in the Sydney area, offers a number of products in addition to the regulated tariff, including: a one year contract with an 11 per cent discount off the green energy rates; and a three year contract with a three per cent discount on the consumption and supply charges and a further three per cent discount, excluding network charges, for paying bills on time. Origin is the Standard Retailer in Dubbo, where it offers: a one year contract with a seven per cent discount for paying on time and a one per cent discount for paying by direct debit; and a contract with no fixed term with a one per cent discount off usage rates where paying by direct debit. These offers were available according to the AER's *energymadeeasy* website on 5 September 2013.

43 AP&G, *Investor Update, March 2013*, p. 8.

44 Origin, *2013 Half Year Results Announcement*, 21 February 2013, p. 33.

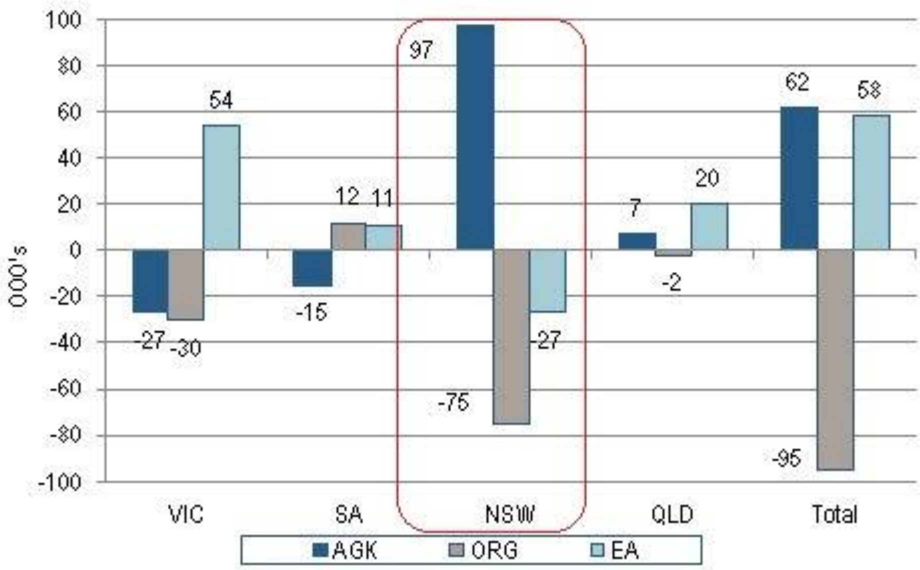
Figure 4.4 Switching between the "Big 3" and other retailers



Source: data provided by AEMO.

Moreover, Figure 4.5 below implies those retailers that purchased the NSW government retail businesses are losing market share and that AGL is gaining market share at the incumbent retailers' expense. This Figure also shows that the incumbents continue to lose market share to new entrant retailers.

Figure 4.5 "Big 3" market share fluctuations - 12 months to June 2013



Source: Credit Suisse, Integrated Utilities Update, 10 September 2013.

Product differentiation

There is evidence of product differentiation in the NSW market; however, it appears to be less innovative than the Victorian market. Most product differentiation in NSW for both residential and small business consumers occurs in the form of discounts and/or cash rebates commonly linked to conditions, such as requiring payment by direct debit.

Reasons for lower product differentiation in NSW than in Victoria may include:

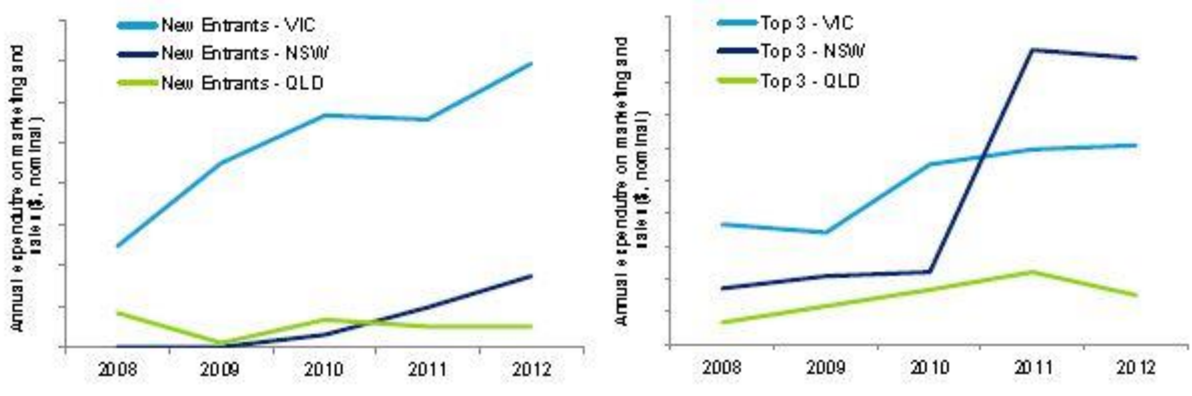
- the regulated tariff serves as a "focal point" for retailers; and
- low availability of interval and smart meters in NSW.[45]

Despite this, between late 2010 and 2012 there were at least 102 unique offers to small consumers for electricity across NSW.[46] Retailers note there has been an increase in the level of price discounts being offered and that retailers are more aggressive about making counter offers to retain existing customers.[47]

Marketing

While product differentiation appears limited compared to Victoria, the level of marketing suggests competition is increasing. The below Figure 4.6 illustrates a step increase in marketing by the big three retailers and a gradual increase in spending by new entrant retailers.

Figure 4.6 Total marketing and sales expenditure



Source: Research undertaken by Deloitte Access Economics in 2012, supplied to the AEMC by, and used with the permission of, the Energy Retailers Association of Australia.

This significant increase in marketing expenditure may partly reflect the fact that AGL did not purchase an incumbent retail business and was then marketing heavily to

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45 These points are considered in greater detail at section 4.4.2 of the Draft Report.

46 NERA, *Prices and Profit Margin Analysis for the NSW Retail Competition Review*, 25 February 2013, p. 31.

47 Sapere Research Group, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales - Report of Interviews with Energy Retailers*, February 2013, p. 10.

attract new customers. In contrast, EnergyAustralia and Origin are working to retain their newly acquired customer base.

4.2.4 Consumers are generally satisfied with their market experience

High levels of consumer awareness and high switching rates do not provide a full picture of whether there is effective competition in a market from a consumer perspective. Importantly, consumers must be satisfied with the range of products available to them and the choices they make.

A survey conducted by Roy Morgan found that of those consumers who have switched, the majority were satisfied with their new retailer,[48] whereas 13 per cent of respondents who have switched reported being dissatisfied with their new retailer.[49]

The Roy Morgan survey also found that a majority of consumers considered the switching process easy and taking as long or less time than expected.[50] Of those consumers who have switched retailers, only five per cent did so because they were unhappy with their existing electricity retailer. For those consumers who have not switched, 36 per cent reported not doing so because they were satisfied with their existing arrangements.[51]

While the majority of respondents did not report negative experiences with their retailer, when asked whether they had been transferred to another retailer without their consent, seven per cent responded that they had.[52] However, in recent consumer surveys conducted on behalf of the AEMC, only one per cent of respondents reported their primary reason for switching was due to being transferred without their consent.

We note retail price regulation does not prevent such conduct by retailers and there are existing consumer protections, such as the National Energy Customer Framework and the Australian Consumer Law, to deter and remedy these situations.

We also note that a number of focus groups conducted on behalf of the AEMC found there was considerable lack of consumer trust of retailers.

On the whole, the available evidence suggests consumers are satisfied with their electricity market experience. These results are supported by an Australia-wide survey by CHOICE that found 91 per cent of consumers rated their current electricity retailer as fair, good, very good, or excellent.[53] While there are clearly areas where consumers consider retailers should improve their service performance, particularly with respect

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48 Roy Morgan, *Survey of Residential Customers of Electricity and Natural Gas in New South Wales: Effectiveness of Retail Competition*, 28 February 2013, p. 28.

49 Ibid, p. 28.

50 Ibid, p. 25.

51 Ibid, p. 22.

52 Roy Morgan, *Survey of Business Customers of Electricity and Natural Gas in New South Wales: Effectiveness of Retail Competition*, 28 February 2013.

53 CHOICE, Issues Paper submission, 8 February 2013, p. 19.

to providing clear information, the majority of consumers appear satisfied with the choices available and their market decisions.

Consumer complaints about electricity retailers

Complaints about NSW electricity retailers have increased over time, but the level of complaints do not appear to be disproportionately high compared to other states. The Electricity and Water Ombudsman of NSW (EWON) appears to have received fewer complaints than its Victorian and South Australian counterparts. The table below shows the number of complaints received by the Ombudsman in each state for the 2011/12 financial year.

Table 4.1 Complaints to ombudsmen about electricity retailers

	NSW	Victoria	South Australia
Number of complaints per 1,000 customers	5.5	18.7	9.5

Source: Calculated using data from: EWON, *Annual report 2011-2012*; EWOV, *Annual report 2011-2012*; ESCOSA, *Performance of the South Australian retail energy market - customer service - 2011/12*, and electricity customer numbers.

We note the relatively high level of complaints in Victoria as compared to South Australia and NSW. We understand a significant proportion of these complaints relate to the roll-out of smart meters in that state and billing problems associated with this program.[54]

4.2.5 Profit margins are consistent with a competitive market

Profit margins can provide an indication of the level of competition in a market. If profit margins are persistently very high, retailers may be earning profits in excess of the efficient cost of supply and the market may not be effectively maintaining downward pressure on prices.

It is difficult to identify an appropriate benchmark with which to compare profit margins in the retail market. We have therefore focussed on whether the regulated profit margin has been sufficient to support competitive activity.

The AEMC engaged NERA to undertake an analysis of retailer profit margins since 2002 and comment on the implications for competition. NERA found profit margins in electricity under the regulated tariff "were adequate to support effective competition in

54 EWOV received 5,234 smart meter cases in 2011-2012, with 4,962 of these cases being complaints, representing a 66 per cent increase from 2010-2011. See EWOV 2012 Annual Report, p. 25. Available at www.ewov.com.au.

NSW between 2002 and 2012".[55] Their results are set out in the table below for each network area and under three different assumptions about wholesale costs, conducted over two periods: 2002-2007 and 2008-2013.

Table 4.2 Implied retail margins to supply a representative electricity customer (7,500 kWh) by distribution area

Distribution area	Low wholesale cost	Medium wholesale cost	High wholesale cost
FY2002 - FY2007			
Ausgrid	10%	6%	2%
Endeavour Energy	10%	6%	2%
Essential Energy	13%	10%	6%
FY2008 - FY2013			
Ausgrid	9%	5%	2%
Endeavour Energy	13%	10%	7%
Essential Energy	11%	9%	6%

Source: NERA, *Prices and Profit Margin Analysis for the NSW Retail Competition Review*, 25 February 2013, p. 37.

This analysis shows in recent years there appears to have been sufficient margin to support competition and to enable new entrants to offer prices at a discount to the regulated price while maintaining a margin for profit. Incumbents are responding to this price-based competition and offering discounts to the regulated tariff as well.

4.2.6 Time-of-use tariffs

SCER asked the AEMC to undertake a review of, and provide advice on, the availability and take-up of time-of-use tariffs by small electricity consumers in NSW and the effect such tariffs may have on competition. This section provides a summary of our findings on this issue.[56]

Availability, prevalence and take-up of time-of-use tariffs

To be offered a time-of-use retail tariff, a customer must have a meter installed at their premises that is being read on an interval basis. Currently, there are approximately 446,000 of these meters installed in small consumers' premises in NSW and being read

55 NERA, *Prices and Profit Margin Analysis for the NSW Retail Competition Review*, 25 February 2013, p. 46.

56 For more detailed analysis of this issue, see Chapter 4 and Appendix D of the Draft Report.

on an interval basis, representing approximately 13.5 per cent of small electricity consumers in NSW. Another 343,500 are read on an accumulation basis.

Competition issues associated with time-of-use tariffs

Although the number of small consumers on a time-of-use tariff is currently quite low, time-of-use tariffs are expected to become more prevalent as more interval read meters are rolled out and as customers' understanding of these products improve. It is timely, therefore, to consider any competition issues associated with time-of-use tariffs and, if so, whether additional measures may be needed to address these issues.

Based on the assessment of a number of competition indicators, it appears there is a reasonable degree of competition to supply this segment of the retail electricity market. For example, all retailers currently offer a time-of-use product. However, a number of significant competition-related issues affecting market participants remain.

The range of tariff structures offered to small consumers appears to depend more on network charging policies used by network businesses than customer preferences. Consequently, some customers have found it difficult to change from a time-of-use tariff to a flat or inclining block tariff.

This may be, in part, due to retail price regulation, which may limit the willingness of retailers to offer consumers on a time-of-use network charge a flat or inclining block retail tariff. We understand that EnergyAustralia is currently the only retailer that offers consumers a flat tariff if they have a meter read on an interval basis. Consequently, current levels of competition do not appear to support consumer choice between flat or inclining block and time-of-use retail tariffs.

In the AEMC's Power of Choice review we suggested a policy framework is required to clarify whether small consumers should have a choice between time of use and flat or inclining block retail tariffs. Our specific recommendations are contained in our final report for that review.[57] We note SCER is currently developing its policy on this issue.

We also found small consumers are not currently in a position to participate effectively in this segment of the market due to low consumer knowledge.[58] In light of this, we consider it would be useful to include information on time-of-use tariffs in any consumer engagement programs proposed in the supplementary report.

4.3 Submissions

Most submissions supported our finding that competition in the electricity market for small consumers is effective. For example, IPART indicated its support for the AEMC draft findings that competition is sufficient to enable all consumers to benefit from

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57 See AEMC 2012, *Power of Choice review - giving consumers options in the way they use their electricity*, Final Report, 30 November 2012, Sydney, Chapter 6 for a full discussion of our recommendations.

58 Roy Morgan, *Retail Competition in the NSW Electricity and Natural Gas Markets: Focus Groups with Residential and Small Business Consumers*, 28 February 2013, pp. 2 and 10.

removing retail price regulation.[59] Simply Energy noted its strong support for the findings of the Draft Report showing that the level of competition is effective in the electricity market.[60] The Energy Retailers Association of Australia also noted its agreement with the AEMC's assessment that competition in the NSW retail electricity market is effective.[61]

We note that ActewAGL, Alinta Energy, EnergyAustralia, ERM Power, the Energy Supply Association of Australia, Lumo Energy, and Origin Energy each agreed with our findings.[62]

While Momentum Energy also agreed with our finding that competition in the electricity market for small consumers is effective, it expressed concern with the fact that the first tier retailers have a combined market share of 95 per cent. Momentum Energy submitted that this constrains the extent to which the current level of competition can be enhanced.[63]

The AER noted that the AEMC's analysis on the effectiveness of competition appeared to raise some issues with existing retail markets, including high market concentration and low product differentiation.[64]

IPART noted standard retailers continue to lose market share within their supply areas.[65] Simply Energy also noted that second-tier retailers in Victoria have grown their market share from 0 per cent to 29 per cent of the market within 9 years and market concentration has nearly halved.[66] This observation suggests that when price regulation is removed, market concentration appears to fall as new entrants establish themselves and win market share.

PIAC did not oppose the removal of retail price regulation in urban NSW, noting that the retail electricity market is ready for the removal of price regulation.[67] However, PIAC reiterated its concerns from its response to the Issues Paper about the effectiveness of competition in the rural and regional electricity markets.[68]

CHOICE disagreed with the AEMC's findings, submitting that competition is not sufficiently effective and noting that it does not support the removal of retail price regulation.[69] CHOICE remained of the view that consumer competitive pressure on

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59 IPART, Draft Report submission, 26 June 2013, p. 2.

60 Simply Energy, Draft Report submission, 5 July 2013, p. 1.

61 Energy Retailers Association of Australia, Draft Report submission, 5 July 2013, p. 1.

62 Each of these firms' submissions is publicly available on the AEMC website.

63 Momentum Energy, Draft Report submission, 5 July 2013, pp. 1-2.

64 Australian Energy Regulator, Draft Report submission, 4 July 2013, p. 5.

65 IPART, Draft Report submission, 26 June 2013, p. 1.

66 Simply Energy, Draft Report submission, 5 July 2013, p. 2.

67 Public Interest Advocacy Centre, Draft Report submission, 5 July 2013, p. 16.

68 Ibid, p. 2.

69 CHOICE, Draft Report submission, 10 July 2013, p. 4.

energy retailers in NSW is currently ineffective. CHOICE also noted that even if the level of competition is considered by the AEMC to be presently sufficiently effective to recommend the removal of retail price regulation, there is no surety that such a removal will lead to the current level of competition remaining or improving.[70]

CHOICE also notes that the Essential Services Commission of Victoria has recently commissioned a report suggesting Victorian consumers have not been able to act as an effective competitive restraint on retailer profit margins.[71]

Similarly, the NSW Irrigators' Council submitted that it does not consider competition to be effective, particularly in rural areas.[72]

4.4 Further analysis

The Commission remains of the view that competition in the small consumer retail electricity market is effective and providing benefits to consumers. Greater consumer choice, low barriers to entry, active consumer switching behaviour, and the presence of independent rivalry is and will continue to provide necessary competitive pressure on electricity retailers in NSW. This is evidenced by the fact that new retailers are entering the market and offering discounts and incumbents are responding to this competitive pressure by offering discounts of their own.

This gives the AEMC confidence in its recommendation that the retail electricity market is operating in such a manner that it will foster greater competition whilst providing benefits to consumers.

4.4.1 Consumers are active

Consumers remain active and switching rates continue the overall trend as illustrated by the updated regional switching chart at Figure 4.2 above. Further qualitative and quantitative analysis undertaken for the AEMC by Newgate Research, to be presented with our supplementary report in October 2013, indicates increasing levels of consumer awareness, both of their ability to choose a retailer and energy issues more generally. Of 1,200 consumers surveyed, 95 per cent were aware they could choose their energy plan and 90 per cent were very, quite, or fairly interested in energy issues.

Further, 43 per cent of respondents were quite or very confident that they understand the various options and offers available to energy consumers. This survey also found that although a majority of respondents initially indicated they were unlikely to switch retailers in the next 12 months, over half indicated they would be interested in a better deal if one was available.

70 Ibid.

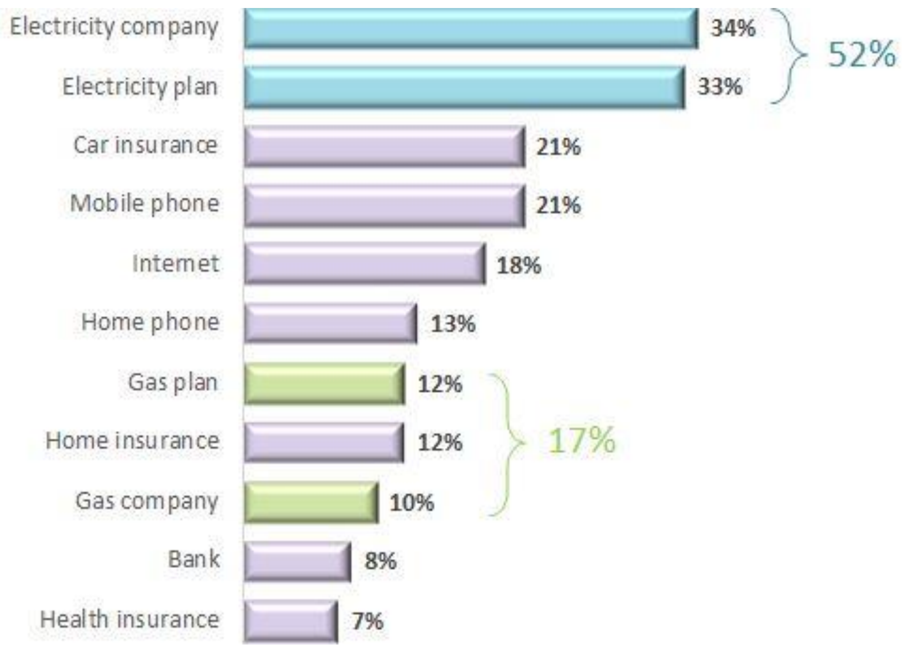
71 Ibid.

72 NSWIC, Draft Report submission, p. 4.

However, more detailed questioning indicated that consumers may overestimate their knowledge of the options available to them. For example, the qualitative research showed many consumers have limited knowledge of the range of options available to them and are not aware that they can lower their energy costs by changing plans with their existing retailers.

As noted in Figure 4.7 below, more than half of those surveyed indicated they had switched their electricity retailer or changed their electricity plan in the past two years. This rate is higher than other consumer industries, such as banking, health insurance, and home insurance.

Figure 4.7 Consumer reported switching behaviour over last two years



Source: Newgate Research, *NSW Consumer and Stakeholder Research*, 20 September 2013.

In order to understand more about the approximately 40 per cent of consumers who remain on regulated tariffs, the AEMC also undertook quantitative research into the state-wide prevalence of consumers on regulated tariffs and correlated these findings with important socio-economic and demographic indicators.

Due to the confidential nature of the data underpinning this analysis, much of which was provided to the Commission by energy retailers, and the inherent predictive qualities of this data, we are unable to publish these findings in full.

However, we are able to provide an overview of some important characteristics of consumers who remain on regulated tariffs.

Key findings from this analysis include:

- regional consumers are more likely than urban consumers to be on a regulated tariff;
- urban NSW locations correlated with a greater proportion of consumer groups on regulated tariffs are associated with greater economic advantage, an older population, higher levels of education, and smaller households; and
- in contrast, country NSW locations correlated with a greater proportion of consumer groups on regulated tariffs are associated with greater economic disadvantage, lower levels of education, and lower levels of mortgages or rents.

These findings will assist the NSW government to target effectively any consumer engagement programs.

In line with a recommendation of our Power of Choice review, SCER has tasked the AEMC with conducting a review into electricity customer retailer switching arrangements. This review will examine the efficiency of current switching rules and processes and work with jurisdictions and key stakeholders to consider consumer switching arrangements, particularly regarding the time it takes to effect the switch from a consumer's initial request.[73]

4.4.2 Retailers can enter, expand, and exit the market

We remain of the view that barriers to entry in the electricity market are low for new entrants. This is evidenced by the recent entry of Click Energy into the NSW electricity retail market in March 2013.

We note that obsolete tariffs in electricity do not appear to have impacted the ability of retailers to enter regional electricity markets.

4.4.3 Independent rivalry

Since the release of the Draft Report, the Commission has observed the available offers around NSW on the AER’s comparison website.[74] This snapshot from the Energy Made Easy website of available offers and number of retailers in the following communities gives an indication of the level of rivalry:

- Sydney metropolitan area: 50 offers from 12 retailers;
- Broken Hill: 38 offers from 11 retailers; and
- Tamworth: 43 offers from 12 retailers.

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73 See SCER Meeting Communiqué, 31 May 2013, available at www.scer.gov.au/meetings/.

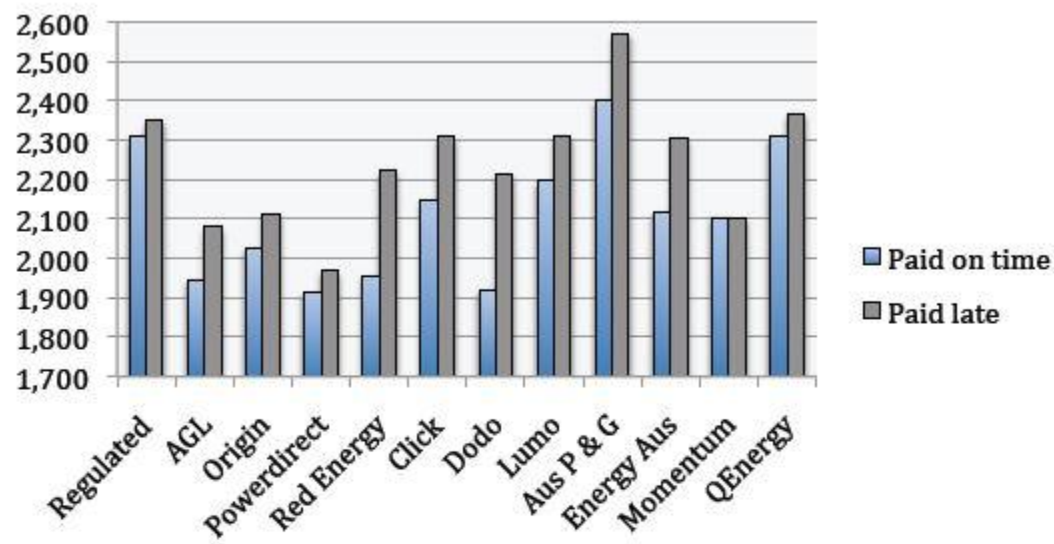
74 See www.energymadeeasy.gov.au/.

Consistent with the findings from the Draft Report, all retailers offer a tariff structure the same as the regulated price (being a two part tariff, with most offering three consumption blocks).

We also note the recent St. Vincent de Paul Society report on NSW energy prices for July 2012- July 2013.[75] This report noted that consumers who switch from the regulated electricity tariff to one of the better market offers can save up to $300-$400 on their annual bills if paid on time.[76]

Moreover, this report also showed that, for nearly all electricity market offers, consumers who paid all their bills late would still be better off financially than those consumers who stay on the regulated tariff.[77] This insight is especially important for those consumers experiencing financial distress, yet remain on the regulated tariff.

Figure 4.8 Consumers pay more for the regulated rate than for market contracts, even when routinely paying bills late



Note: Chart shows estimated annual bill for customers that pay on time versus those that pay late in the Ausgrid network area. Annual bills are based on electricity offers as of July 2013, a single rate tariff, 7200kWh consumption, GST included. Note the Y axis units on this chart represent dollars.

Source: St. Vincent de Paul NSW Tariff-Tracking Project 2013.

The above chart shows that the regulated price is not the best price, even for consumers who pay their bills late. Of course, for those consumers able to pay their energy bills on time the discounts of most market offers relative to the regulated rate are much greater.

75 See St. Vincent de Paul Society, New South Wales Tariff-Tracking Project, May Mauseth Johnston, August 2013.

76 We note this is based upon annual consumption of 7,200kWh on a single rate, including GST. IPART currently uses an average of 6,500kWh.

77 Ibid, Table 5.

The Commission notes AGL's 15 July 2013 announcement that it has entered into agreements for the acquisition of 19.9 per cent of the issued shares of Australian Power and Gas (AP&G) and that it intends to make an off-market takeover offer to acquire all of the issued shares of AP&G it does not currently have an interest in.

We note the Australian Competition and Consumer Commission announced on 12 September 2013 that it will not oppose the proposed acquisition by AGL of AP&G. The AEMC does not consider this proposed transaction would alter our recommendations in this review in any material way.

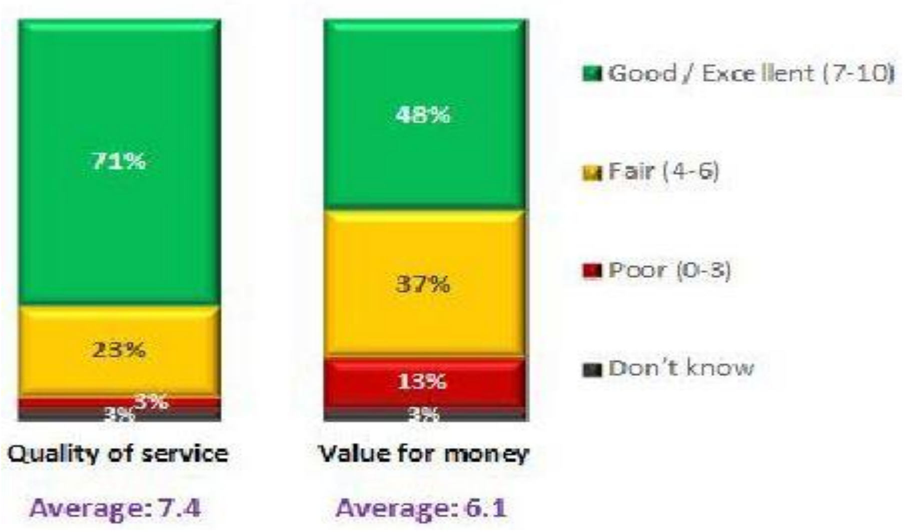
While the proposed acquisition would remove a new entrant from the market, the Commission notes that competition is a process in which changes in industry participants are expected. Importantly, we note we have found there are no significant barriers to entry in the electricity market. Where new firms can enter and exit the market without significant barriers, competitive pressure should be maintained on any dominant market participants.

We note, for example, Alinta Energy has indicated the removal of retail price regulation would make it more amenable to entering the small consumer market in NSW.

4.4.4 Customer satisfaction

Surveys conducted by Newgate Research indicate most respondents were satisfied with the quality of service provided by their electricity retailer, with 71 per cent of respondents rating their electricity company as good or excellent. Respondents' reporting of value for money was, however, rated significantly lower, as illustrated in Figure 4.9 below.

Figure 4.9 Consumer perceptions of quality of service and value for money



Source: Newgate Research, *NSW Consumer and Stakeholder Research*, 20 September 2013.

Supporting these survey results on perceptions of quality of service, 33 per cent of electricity consumers and 10 per cent of gas consumers chose to change their energy plan with their existing retailer.

However, qualitative research conducted by Newgate Research indicated that some consumers have had significant negative experiences in their dealings with their electricity retailers. In particular, a significant number of survey participants expressed concerns about the behaviour of door-to-door salespersons. The major retailers in NSW have ended or will soon end door-to-door marketing. These surveys also indicated a low level of consumer trust of electricity retailers, with a significant proportion of consumers agreeing with the statement they 'don't trust companies that offer a better deal because they will end up charging more later on'.

4.4.5 Profit margins

In May 2013, the Essential Services Commission (ESC) of Victoria released a discussion paper on retailer margins in Victoria's electricity market.[78] The discussion paper was accompanied by a study conducted by SKM-MMA that analysed electricity prices and retail margins over the period 2006 to 2012.

The ESC's discussion paper notes that the SKM-MMA analysis observes an increase in retail margins over the period of analysis.[79] The ESC notes that the gap between gross margins on market offers for Tier 1 retailers and gross margins for smaller retailers has reduced over time. The ESC also notes that the spread between standing offers and market offers of Tier 1 retailers has increased over time.

By 2011-12, gross margins on Tier 1 market offers were approximately 16 percentage points lower than gross margins on standing offers. The ESC attributes this to large increases in host retail standing offer prices. Finally, the ESC notes that approximately 75 per cent of residential customers are on market offer contracts.[80]

A report prepared by Deloitte for the Energy Retailers Association of Australia highlights potential shortcomings in the price and revenue assumptions used by SKM-MMA, which may result in an overestimate of margins.[81]

This report also noted differences in the manner in which wholesale energy costs, a large proportion of retailers' costs, were modelled as compared to regulators.[82]

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78 See Essential Services Commission, *Retailer Margins in Victoria's Electricity Market - Discussion Paper,* May 2013.

79 ESC, Retailer Margins in Victoria's Electricity Market: Discussion Paper, May 2013, pp. 10-11. The ESC's commentary applies to customers on single rate tariffs. The ESC notes that gross margins from customers on dual rate or time of use tariffs are generally lower.

80 SKM-MMA, *Analysis of Electricity Retail Prices and Retail Margins 2006-2012*, Report for Essential Services Commission, 10 May 2013.

81 Deloitte, *Energy Retailers Association of Australia: Retailer Margins in Victorian Electricity Market, Final Report*, 24 June 2013.

We note calculating margins is not a straightforward exercise; as highlighted by comments in the Deloitte report, there are different ways to approach this type of analysis. The ESC noted that without more observations, caution should be exercised in interpreting such findings before making inferences about the degree of competitive pressure in the market.

The Commission considers a range of indicators are required to assess the degree of competitive pressure in the market. Such a range will be part of the ongoing market monitoring regime, as discussed in chapter 7 below.

4.5 Conclusion

The Commission considers the NSW retail electricity market for small consumers is effectively competitive. Competition could be enhanced by implementing measures to assist customers to understand better their electricity consumption and options to change tariffs. These issues will be addressed in our supplementary report.

The Commission considers there is a high degree of engagement in the electricity retail market by small consumers and this engagement has been increasing. Customers are acting on their ability to choose their electricity retailer. Switching rates have increased markedly in the last two years across all network areas. Further, customers surveyed were more likely to have switched their electricity provider than other utilities.

The Commission is confident that competition in NSW is sufficiently robust to promote consumer choice.

We also consider it needs to be easier for consumers to understand and compare offers. Since publication of the Draft Report, the Commission has undertaken thorough social research and consulted widely with consumer groups, retailers, small business representatives, and an advocate for vulnerable consumers, to identify small consumers' needs in terms of the information, tools and protections they require to compare offers and choose plans.

There is mixed evidence of consumer satisfaction in the retail electricity market. Surveys conducted for this review indicate consumers are generally satisfied with the quality of service they receive, but there are a number of areas where retailers can improve their service, such as providing clear and accessible information relating to their products.

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82 Deloitte noted jurisdictional regulators utilise some aspects of long run marginal cost estimates as well as a different approach to estimating contract prices. It also noted that long run marginal cost estimates "are a proxy for the cost of self-generation and the inclusion of these estimates better reflects the underlying cost structure of the retailers, given significant vertical consolidation" (ibid, p. 11). The NERA report prepared for the AEMC also uses a range of long run marginal cost estimates to generate wholesale energy costs (see NERA, *Prices and Profit Margin Analysis for the NSW Retail Competition Review*, a report to the Australian Energy Market Commission, 5 March 2013).

In October 2013, the Commission will be releasing a supplementary report with recommendations to help consumers access information they need to choose an energy plan that is best suited for their circumstances.

The Commission sees no evidence of significant barriers to entry. A number of new retailers entered the market in the last few years. However, the Commission does have some concerns about the ability of small retailers to obtain hedges, depending on the outcome of the proposed sale of the NSW government's generation assets.

Regarding the prevalence of obsolete tariffs, we note Origin Energy has committed to rationalising its obsolete tariffs in the Essential Energy supply area.[83] Further, the presence of the obsolete tariffs does not appear to have inhibited entry by electricity retailers into regional areas.

There are signs of independent rivalry in the NSW retail electricity market, primarily around price-based competition. While market concentration is higher and product differentiation is more limited than in Victoria, small retailers are winning market share, as demonstrated in Figure 4.4 above. We are of the view that the removal of price regulation will foster the conditions necessary for the emergence of new market participants and will encourage greater product differentiation.

The Commission considers historical retail profit margins have supported competitive activity. Retailers have responded to customer switching behaviour by offering tariffs below the regulated price. This evidence of price-based competition gives us confidence that retail price regulation is not required to constrain prices to efficient levels. The Commission considers there is sufficient rivalry in the electricity market to keep competitive pressures on prices.

In relation to time-of-use tariffs, there is some competition to supply this market segment, but a number of competition-related issues remain. These issues were raised and recommendations were provided in the Power of Choice review. We note the SCER is currently developing a policy position on these issues.

83 Origin Energy, Draft Report submission, 5 July 2013, p. 9.

5 Assessment of competition in the gas market

Box 5.1: Summary of chapter

The Commission's conclusion is that competition in the gas market is providing benefits to the majority of small consumers through choice of their retailer and energy product. This conclusion is based on the following findings:

1. Consumers are active in the market: 14 per cent of consumers switched their gas supplier last year, primarily to obtain a better price. This rate has increased in the last six months. More than 70 per cent of gas consumers are on a market contract. As with electricity, improvements need to be made to the clarity and accessibility of information.

2. There are some barriers to retailers entering the market compared to electricity: accessing gas supply and pipeline capacity with a small customer base is challenging. However, second-tier retailers have entered the market and are gaining market share, suggesting barriers are not major.

3. There are limited signs of independent rivalry: market concentration is high, there is limited product differentiation, and there are fewer gas offers than in electricity, particularly in regional areas. This likely reflects the nature of domestic gas consumption in NSW, the relatively small customer base of regional areas, and the relatively low retail tariffs presently available in some of these areas.

Outcomes in the market appear consistent with effective competition:

4. Customers are generally satisfied with their experience in the market: the majority of customers appear satisfied with their retailers and the switching process, but are demanding more transparent information.

5. Profit margins are consistent with a competitive market: the regulated tariff has sufficient headroom to support competitive activity. New retailers are offering discounts and incumbents are responding by offering discounts.

5.1 Introduction

In the previous chapter, the Commission concluded that competition in the electricity market is effective. This chapter sets out our findings for the gas market. The Commission has considered the same factors as in the assessment of the electricity market.

This chapter is set out as follows:

- section 5.2 sets out a summary of the Draft Report;
- section 5.3 summarises submissions received in response to the Draft Report;
- section 5.4 provides further analysis, including our response to submissions; and
- section 5.5 provides the Commission's final conclusions.

5.1.1 Differences between gas and electricity

The nature of gas and electricity consumption in NSW is very different. These differences provide important context for our findings of the nature of competition in the gas sector. First, fewer people are connected to gas than electricity. There are 1.2 million gas customers compared to 3.3 million electricity customers in NSW. Second, gas is typically used in households for a minority of energy needs, such as for hot water and cooking. Average expenditure on gas, therefore, is fairly low when compared to electricity.

These factors have two important implications. One, the NSW gas market may not be as attractive to retailers as the Victorian market due to low gas penetration and volumes.[84] Therefore, we might reasonably expect to see fewer retailers entering the gas market in NSW than in Victoria.

Two, consumers may be less willing to invest the time and effort to research the best market offer because the cost of gas represents a proportionally smaller expense than electricity. This, in turn, may contribute to lower consumer engagement compared to electricity, where significant price rises over the past few years have brought the cost of electricity into the spotlight.

We note that there has historically been fewer regulatory controls in the gas retail market compared to electricity. One reason for less regulatory intervention in gas is the ability of many consumers to substitute energy sources. Whilst it is not practicable to replace electricity with gas entirely, it is possible to replace gas with electricity, at least in the long run. This substitutability has been viewed to act as a market mechanism to limit prices and therefore justify a lower level of regulatory control.

84 Victoria's penetration rates and gas consumption is higher than NSW because more consumers live in wetter, colder areas and rely on gas for heating.

5.2 Findings from the Draft Report

5.2.1 Consumers are active in the market

The available evidence suggests that consumers are active in the gas market, although less so than in electricity. We note, for example, less than 30 per cent of consumers remain on the regulated gas tariff.

Awareness is high

The Roy Morgan survey found 86 per cent of residential gas customers were aware they could choose their gas retailer. This compares to 91 per cent in Victoria and 84 per cent in South Australia at the time competition reviews were undertaken in those states.[85] However, small business gas consumers in non-metro areas were significantly less aware of their ability to choose their retailer than other consumer groups.[86]

Consumers are switching

The upward trend of electricity switching rates is mirrored in the gas market, with switching rates increasing since privatisation. Quarterly switches by gas consumers since full retail contestability began are shown in Figure 5.1. In 2012, 14 per cent of consumers switched their gas retailer.[87] This is lower than current rates of 23 per cent in Victoria and 16 per cent in South Australia.[88]

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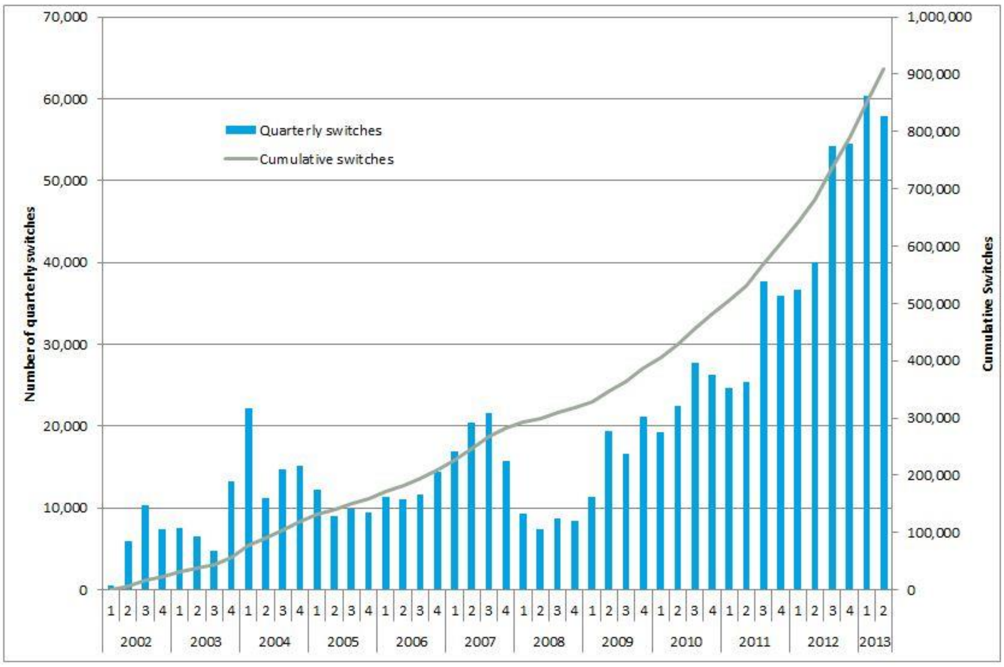
85 AEMC 2007, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria*, First Final Report, 19 December 2007, Sydney, p. 7; and AEMC 2008, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia*, First Final Report, 19 September 2008, Sydney, p. 22.

86 Roy Morgan, *Survey of Business Customers of Electricity and Natural Gas in New South Wales: Effectiveness of Retail Competition*, 28 February 2013, p. 9.

87 Data provided by AEMO.

88 Ibid.

Figure 5.1 Quarterly switches by gas consumers



Source: Data provided by AEMO.

Information provision needs to be improved

Results from the Roy Morgan survey regarding information provision for gas were similar to the findings in electricity. Gas customers surveyed generally found information on gas offers difficult to understand and unhelpful for making an informed choice. The Commission considers that, as for electricity, the effectiveness of competition could be improved by better equipping customers with the tools and confidence they need to choose a plan that best suits their circumstances.

5.2.2 Retailers have entered but some barriers exist

Although the Commission's draft findings were that there are no substantial barriers to entering the electricity retail market, we expressed concerns about retailers' ability to offer gas to small consumers, specifically relating to the supply and transport of gas, interface systems with distribution networks, exit costs and, in some areas, the level of existing tariffs. The reasons for this view are summarised below. We consider this matter further at section 5.4 below.

The gas market operates very differently from electricity, where trading takes place via the National Electricity Market and risk can be managed through derivatives. Wholesale gas is primarily traded on a confidential basis between gas producers and retailers through long-term contracts. Retailers must also source pipeline capacity to ship the gas to the customers through long-term contracts with pipeline owners.

In addition, gas producers and shippers generally require retailers to adopt "take or pay" contracts, meaning retailers are required to pay for the full contracted amount of gas and pipeline capacity even if it is not utilised.

Sourcing wholesale gas and shipping contracts may therefore present a challenge to new retailers, particularly those with a small or uncertain customer base.

The gas short-term trading market (STTM) has been raised by some retailers as an alternative source of gas supply.[89] The STTM allows market participants to buy or sell wholesale gas where their contracted supply of gas does not meet their demand on any given day. However, the STTM is primarily a balancing mechanism that was not designed to operate as a wholesale supply market. Consequently, it is not very liquid.

Further, there is no secondary market to allow participants to hedge STTM price volatility. For these reasons, the Commission does not consider the STTM to provide a feasible gas supply alternative for prospective new entrants.[90]

Exit costs could act as a barrier to entry due to the long term nature of gas supply and shipping contracts. One retailer in interviews noted a gas retailer could only exit the market when its gas and pipeline network contracts expired.

Concerns were raised in interviews with some retailers about the interface with gas distribution networks in NSW. This issue stems from the type of information system retailers in NSW must use to communicate with distribution networks, which differs from that used in Queensland, South Australia, and Victoria. This difference, retailers suggested, imposes an additional cost on retailers, particularly new retailers, to learn and implement different systems from the other jurisdictions.

Finally, there remain a number of consumers on tariffs that make it difficult for other retailers to offer competitive tariffs in these areas. Consequently, product and retailer choice in these areas is limited.

Removing price regulation may resolve this barrier; however, it could also cause price rises for customers currently on these tariffs. These customers may therefore be worse off if regulated retail prices are removed. This issue is considered further below in relation to stakeholder submissions on this point.

Despite these potential barriers, the Commission noted that new retailers had entered the market and were winning market share.

5.2.3 There is limited independent rivalry

There appears to be less independent rivalry in gas than in electricity. Market concentration is higher than in electricity and product differentiation is more limited.

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89 AGL, Issues Paper submission, 13 February 2013, p. 6.

90 We note SCER is currently progressing reforms in this area.

There are currently six gas retailers in NSW.[91] AGL, Origin Energy and ActewAGL are standard retailers. However, AGL and ActewAGL do not compete within each other's supply areas. Consequently, there are, in effect, five active retailers in the market.

Market concentration is high. The three largest retailers together hold a 97 per cent share of the gas market. However, high market concentration is not necessarily a sign of a lack of competition.

Consumers are switching between retailers. For example, AGL has lost market share from 66 per cent of the residential market as at 30 June 2011[92] to 63 per cent as at 30 June 2012.[93] Between July 2011 and December 2012, AGL lost 2.5 per cent of its gas customer base, from 716,386 to 692,809 customers.[94]

Origin Energy's gas customer base has grown by 22 per cent in the six months to 31 December 2012.[95]

Similar to electricity, most product differentiation in gas is in the form of discounts and/or cash rebates. Between 2010 and 2012 there were 22 unique dual fuel offers and nine unique gas offers to residential customers.[96] Fewer offers were available for small business customers.

When the Draft Report was published, Origin Energy was the only retailer to offer a discount where customers hold both accounts with them. EnergyAustralia was the sole retailer to offer an alternative tariff structure to the underlying network tariff structure.[97] Jemena, the gas distribution pipeline owner, charges a declining block tariff based on six daily consumption bands. This is mirrored by most retailers.

NERA found the mean discount available for gas was four per cent for a residential consumer and five per cent for a commercial consumer.[98] However, the limited number of offers means it is difficult to draw firm conclusions about the level of discounting.

5.2.4 Consumers are generally satisfied with their experience in the market

The available evidence suggests consumers, on the whole, are satisfied with their gas market experience. Roy Morgan's survey results show that of those consumers that

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91 This will change if AGL acquires AP&G.

92 IPART, *Customer service performance of gas retail suppliers, Information Paper*, December 2012, p. 5.

93 IPART, *Gas retail businesses' performance against customer service indicators in NSW*, Information Paper, January 2012, p. 6.

94 AGL, FY Interim Results, 27 February 2013, p. 40.

95 Origin Energy, 2013 Half Year results announcement, 21 February 2013, p. 33.

96 NERA, *Prices and Profit Margin Analysis for the NSW Retail Competition Review*, 25 February 2013, p. 31.

97 According to IPART's *myenergyoffers* website on 23 March 2013.

98 NERA, *Prices and Profit Margin Analysis for the NSW Retail Competition Review*, 25 February 2013, p. 35.

have switched, 65 per cent reported being satisfied with their new retailer.[99] The most common reason for consumers' satisfaction with their new retailer was because they felt they had secured a better deal.[100] Only five per cent of gas consumers said they were dissatisfied with their new retailer.

The table below sets out the number of complaints per 1,000 gas customers to the Energy Ombudsmen in NSW, Victoria and South Australia. It shows there were marginally fewer complaints per customer to the NSW Ombudsman than in South Australia, and less than half as many as in Victoria.

Table 5.1 Complaints to the Ombudsman about gas retailers

	NSW	Victoria	South Australia
Number of complaints per 1,000 customers	3.4	8.3	3.6

Source: Compiled using information from EWON, *Annual Report*, 2011-2012, p. 16; Energy and Water Ombudsman Victoria, *Annual Report*, 2012, pp. 34, 35, 39, 40; ESCOSA, *Performance of the South Australian retail energy market - customer service* - 2011/12, pp. 3-4.

The number of complaints received by EWON has increased by approximately 20 per cent from the previous year. The top three complaints to EWON concerned billing, customer service and credit.

EWON received 919 complaints about dual fuel accounts in the 2011/12 financial year. This is approximately 1.2 complaints per 1,000 dual fuel customers, representing a 54 per cent increase in complaints about dual fuel retailers since the previous financial year.[101]

5.2.5 Profit margins are generally consistent with competition

The Commission's draft findings were that profit margins on regulated tariffs in the gas market are generally consistent with outcomes expected in an effectively competitive market.

NERA undertook analysis of retailer profit margins since 2002 and found margins on a regulated customer were adequate to support effective competition in gas between 2002 and 2012.[102]

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99 Roy Morgan, *Survey of Residential Customers of Electricity and Natural Gas in New South Wales: Effectiveness of Retail Competition*, 28 February 2013, p. 28.

100 Ibid, p. 30.

101 This is an estimate for the number of complaints received from residential customers based on information provided by gas retailers, the total number of gas customers and the proportion of residential customers connected to the gas network.

102 See Table 5.3 of Draft Report.

Table 5.2 Implied retail margins to supply representative natural gas customer

	Low wholesale cost	Medium wholesale cost	High wholesale cost
FY2002 - FY2007	12%	7%	1%
FY2008 - FY2013	14%	10%	6%

Source: NERA, *Prices and Profit Margin Analysis for the NSW Retail Competition Review*, 25 February 2013, p. 44.

Margins for gas were slightly higher than those for electricity. We note these findings are inconsistent with the general retailer view that gas is less profitable than electricity.[103]

We note that conducting an accurate assessment of margins in gas is particularly problematic due to the confidential nature of wholesale gas contracts and the lack of publicly available reference data. This lack of transparency makes it more difficult to estimate gas retail margins than electricity and introduces considerable room for error when making necessary assumptions about costings.

5.3 Submissions

Most submissions commenting on our findings in respect of gas agreed with our views. However, PIAC raised significant concerns, including uncertainty in the wholesale gas market and the lack of diversity of offers and suppliers outside of the greater Sydney area. In this submission, PIAC notes that IPART, in its most recent gas price determination, decided not to make a price change determination from 1 July 2014 and 1 July 2015, because "there are too many uncertainties to reach agreement on these price changes now."[104]

Momentum Energy reiterated its view from its earlier submission to the Issues Paper that there are significant barriers to entry in the retail gas market, which also impedes entry into the dual fuel market. It noted, however, that these barriers should be addressed through alternative means and should not hold up removing price regulation.[105]

Origin Energy disagreed with the suggestion that there are significant barriers to entry in the retail gas market, noting there are multiple sources of supply and all major gas distribution pipelines are currently covered by access regulation in NSW. Origin

103 See, eg, Sapere, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales - Report of Interviews with Energy Retailers*, February 2013, p. 67.

104 Public Interest Advocacy Centre, Draft Report submission, 5 July 2013, paragraph 2.2.1.

105 Momentum Energy, Draft Report submission, 5 July 2013, p. 2.

Energy did accept, however, that non-cost reflective tariffs may prevent new entrants in some areas.[106]

Origin noted the AEMC's draft advice that some tariffs act as a barrier to entry in rural areas and indicated that it continues to rationalise these tariffs in a measured fashion to minimise price shocks and negative customer experience. Origin notes that it considers the issue is best resolved through the removal of retail price regulation.[107]

Jemena Gas Limited disagreed with the suggestion its bespoke business-to-business (B2B) information system may act as a barrier to entry.[108] Jemena argued that its business interface system enabled retailers to choose the level of automation they wanted to invest in and suggested retailers can operate in the market with only rudimentary interfacing capability. Jemena further noted the potential merit in national harmonisation of B2B procedures, but only where it demonstrates net present value to consumers.[109]

Origin Energy considers the Jemena B2B interface sub-optimal, but not a significant barrier.[110] AGL Energy submitted that it did not consider this system a significant barrier to entry or expansion.[111]

5.4 Further analysis

5.4.1 Uncertainty in the gas sector

There are changes occurring in the gas market in Australia that may impact conditions for obtaining wholesale gas. A number of LNG export facilities are being constructed in Gladstone, which together will represent more than triple the existing gas consumption in Australia. These developments have created significant uncertainty for retailers and gas suppliers alike, particularly in respect of the future wholesale gas price.

We also note the recently proposed merger by gas distribution and transmission company APA Group to acquire its peer, Envestra. It remains to be seen what effect further consolidation in the gas distribution market may have on smaller retailers and whether these firms will be able to conclude economic agreements, particularly on pipelines not subject to regulated access and price terms under the National Gas Law.

PIAC considers that uncertainty in the gas sector is a reason to maintain regulated prices. The Commission's view is that these changes are primarily affecting the upstream supply and price of wholesale gas. While this will have flow-on effects into

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106 Origin Energy, Draft Report submission, 5 July 2013, p. 11.

107 Origin Energy, Draft Report submission, 5 July 2013, pp. 8-9.

108 Jemena, Draft Report submission, 4 July 2013, pp. 1-2.

109 Ibid, p. 2.

110 Ibid, p. 12.

111 AGL Energy, Draft Report submission, 8 July 2013, p. 2.

the gas retail market, price regulation will not prevent the retail price of gas from rising due to increases in wholesale costs. This has already been seen in electricity, where rising distribution network costs flowed into higher retail electricity prices. This is appropriate, as retailers must be able to recover their efficient costs to continue to operate.

Further, an unregulated market is better placed than a regulator to manage the risks and changes arising from the wholesale market. As discussed further in chapter 7, one of the risks of price regulation is the risk of the regulator setting the wrong price, leading to consumers paying more than they should or retailers having to pull out of the market where they cannot recover their efficient costs. This risk is heightened as uncertainty increases. The market provides a more nimble mechanism for adjusting prices as new information comes to light.

5.4.2 Consumers are active

Consumers remain active: switching rates for retail gas consumers have remained steady or increased over the last six months.[112] The percentage of transfers over a rolling 12 month period has ranged from 15 to 18 per cent. As shown in Figure 4.7, 10 per cent of respondents to the most recent survey indicated they had switched their gas retailer in the last two years. A further 12 per cent indicated they had changed their gas plan over the same period.

5.4.3 Retailers can enter, expand, and exit the market

In the Draft Report, the Commission raised concerns about the ease with which new retailers could enter the retail gas market. With the exception of Momentum Energy, submissions from retailers in response to the Draft Report generally did not agree that there are barriers to entering the gas market. Neither AP&G nor Lumo, who have both entered the NSW gas retail market, commented on any potential barriers.

Similarly, other second tier retailers that may be in a position to enter the gas retail market in the future, such as Alinta and Simply Energy, did not raise concerns in their submissions to the Draft Report. Momentum Energy noted that addressing any barriers is best done through alternative processes and should not hold up the removal of retail price regulation.[113]

The Commission continues to hold the view that entering the gas retail market does present greater difficulties than the electricity retail market due to the nature of the supply arrangements. However, the entry of three new retailers, including EnergyAustralia, AP&G and Lumo, suggests that any barriers are not major.

112 See AEMO's Gas Monthly Retail Transfer Statistics for January to July 2013. Available at www.aemo.com.au. Note these transfers include the ACT; however, switching rates in the ACT are very low.

113 Momentum Energy, Draft Report submission, 5 July 2013, p. 2.

With that said, the Commission notes that lower levels of penetration and consumption of gas in NSW, particularly compared to Victoria, may make it commercially less viable to have many retailers competing in the gas sector. This is particularly relevant in regional areas, where the low number of consumers over a very large area, combined with relatively low levels of consumption, and significant marketing costs required to gain customers in regional areas may not support the level of retailers, and thus competition, in urban environments or in Victoria.

5.4.4 Limited evidence of independent rivalry

There are limited signs of independent rivalry for gas, particularly in regional NSW outside the Jemena gas distribution network (Jemena).[114] There are six active retailers across NSW and market concentration is high. There is also limited product differentiation. However, customers are switching between retailers and the largest standard retailer has been losing market share in gas. AGL lost almost four per cent of its gas customer base in NSW in the 2012/13 financial year.[115]

Within the Jemena network, many areas currently have 21 offers available from four retailers. Regional towns serviced by Jemena, such as Dubbo and Wellington, have 10 offers available from two retailers.[116] However, these choices reduce in areas that are serviced by networks other than Jemena.

The Commission notes PIAC's observation of a lack of diversity gas offers and few suppliers in the below regional areas. Analysis of the numbers of offers and retail gas suppliers in these areas using the AER's Energy Made Easy website broadly confirm PIAC's observations. However, we note that since PIAC's analysis was undertaken, EnergyAustralia appears now to be offering gas to small consumers in Albury and the surrounding region.[117]

We also note the Shoalhaven area is not currently subject to competition. This special case is considered in Box 5.2.

114 The Jemena network broadly covers Greater Sydney and includes some regional towns such as Dubbo and Griffith.

115 AGL, FY13 Full Year Results Presentation, 28 August 2013, slide 44.

116 According to the *energymadeeasy* website as at 19 September 2013.

117 This is based on a query of the *energymadeeasy* comparator website on 19 September 2013 of towns including Albury, Corowa, Howlong, Tocumwal, and Mulwala, each of which has 7 offers available from two retailers.

Selection of regional NSW gas offers - Energy Made Easy

Area	Post code	Number of retailers	Number of offers	Offer type
Albury	2640	2	7	Regulated and market tariffs
Cooma	2630	1	1	Regulated tariff
Goulburn*	2580	2	10	Regulated and market tariffs
Gundagai	2722	1	1	Regulated tariff
Henty	2658	1	1	Regulated tariff
Queanbeyan	2620	1	1	Regulated tariff
Tamworth	2340	1	1	Regulated tariff

*Some gas consumers in Goulburn are able to access up to 10 offers from 2 retailers, depending on their gas distribution provider. Consumers whose gas distributor is ActewAGL have access to one retailer and one regulated offer.

Analysis of offers using the Energy Made Easy website suggests that gas prices in these areas are typically lower than those in the Jemena distribution network. These findings are consistent with those of the St. Vincent de Paul Society in its recent tariff tracking report.[118]

These findings suggest that there could be insufficient headroom above the regulated price for other retailers to enter the market. This is consistent with the observation that there are some tariffs remaining in some regional areas that make it difficult for other retailers to compete.[119]

The lack of diversity of gas offers and retailers in some regional areas is therefore likely to be due, at least in part, to the relatively low retail tariffs currently available in these areas. The Commission considers that this issue is best addressed through the removal of retail price regulation. We note that these consumers represent less than 10 per cent of all gas consumers in NSW. As discussed in section 7.5, market monitoring will be particularly important in these regional areas to ensure the competitive market is operating efficiently.

We are of the view that if retail price regulation is removed, these areas are likely to become more attractive for new retailers to enter.

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118 See St. Vincent de Paul Society, *New South Wales Tariff-Tracking Project*, May Mauseth Johnston, August 2013.

119 Origin Energy has indicated that it intends to transition current low regulated tariffs to what IPART considers to be to a "higher, more appropriate level" over the current regulatory period, as set out in IPART, *Review of regulated retail prices and charges for gas from 1 July 2013 to 30 June 2016, Final Report*, June 2013, pp. 40-41.

Box 5.2: The Shoalhaven

The AEMC understands retail gas consumers in the Shoalhaven area are not currently part of the competitive retail market and therefore do not have an effective choice of their gas retailer. These consumers, primarily in Nowra, are supplied by ActewAGL and their tariffs are currently regulated by IPART under a voluntary pricing arrangement.

The Shoalhaven distribution network is explicitly excluded from AEMO's Retail Gas Market Procedures, which set out the obligations of industry participants for the operation of retail gas markets. This exclusion means there is no established mechanism to transfer consumers in this region to another retailer.

The distribution network servicing this area is not subject to an access arrangement. This means no standard terms and conditions are available, which is an important consideration for potential new entrants (although, a new entrant could negotiate access). This also means there is no established balancing mechanism for multiple pipeline users.

These issues suggest there are structural barriers to new retailers entering the market and obtaining customers. Consequently, competition is currently not effective for consumers in the Shoalhaven area.

Despite extensive enquiries, the Commission has not established the basis for excluding the Shoalhaven distribution network from full retail contestability. We understand AEMO is progressing a programme of work to ensure the Grampians, Bairnsdale and South Gippsland areas are covered by the same regulatory framework as other contestable gas networks in Victoria, supporting AEMO's 2013-14 statement of corporate intent to consolidate gas markets.

The Commission recommends the NSW government request AEMO to undertake a similar investigation for the Shoalhaven. Until this is completed, we recommend the Shoalhaven be given particular focus in market monitoring to compare pricing trends with other areas. As discussed previously, if the NSW government is concerned about competition in this area, it may wish to consider retaining a volunteer pricing arrangement for the Shoalhaven.

Price rises in the Shoalhaven have been moderate over recent years. The percentage gas price increase in 2012-2013 in the Shoalhaven, at 3 per cent, was the second lowest of all areas.[120] We see no evidence suggesting these trends would materially change if the NSW government removed price regulation.

The regulated gas prices in this area are typically lower than those in the Jemena distribution network. For example, the annual bills for regulated gas offers in the Shoalhaven area are estimated to be approximately $750 in 2013, whereas the regulated gas offer in other areas is above $850 in that year.

120 Ibid, Table 3, p. 12.

We also note that, over the long term, electricity provides a substitute for gas if prices were to rise significantly relative to the price of electricity.

However, if the NSW government is concerned about the level of competition in the areas listed below, it may wish to consider maintaining voluntary pricing arrangements with the relevant regulated offer retailers until tariffs are rationalised or there is evidence of new market entrants.

The relevant regulated offer retailers are those nominated under the National Energy Retail Law (Adoption) Regulation 2013 for the following distribution systems:

- Envestra (NSW) Pty Limited;
- Central Ranges Pipeline Pty Ltd;
- Albury Gas Co Ltd; and
- ActewAGL Distribution and Jemena Networks (ACT) Pty Ltd.

5.4.5 Consumer satisfaction

Surveys conducted by Newgate Research indicate a majority of respondents were satisfied with the quality of service provided by their gas supplier, with 62 per cent of respondents rating their gas retailer as providing good or excellent service and a further 31 per cent rating their gas retailer's service as fair. This is consistent with earlier findings from the Roy Morgan survey. Respondents' reporting of value for money for their gas supplier was, however, rated significantly lower as illustrated in Figure 5.2 below.

Figure 5.2 Consumer perceptions of quality of service and value for money

Source: Newgate Research, *NSW Consumer and Stakeholder Research*, 20 September 2013.

These findings continue to support our draft conclusion that consumers are generally satisfied with their experience in the market.

5.4.6 Profit margins

AGL's gross margin per gas customer for the half year ending 31 December 2012 was $84.41. This compares with their gross margin per electricity customer of $92.96.[121] Similarly, Origin's gross profit per gas customer was $148, compared to $256 per electricity customer.[122] The gross margins reported by AGL and Origin are, however, not directly comparable because they include different costs in their calculations.

While these figures are for each company's entire operations and not specific to NSW, they support retailers' views that gas has, to date, been less commercially attractive than electricity. Similarly, the revenue pools for gas retailers in NSW are much smaller when compared to retail electricity, in which there are nearly triple the number of consumers. Consequently, we would expect few retailers to enter this sector.

5.5 Conclusions

The findings in this chapter suggest that while the gas market is providing less choice for gas consumers than electricity consumers, both in terms of retailer and product choice, the market is providing competitive outcomes overall.

Consumers are active in the market, and more than 70 per cent have shifted onto a market contract. Switching rates, while lower than for electricity, have remained steady or increased over the last six months. Gas consumers in the Greater Sydney area have access to approximately 21 different offers from four different retailers.

The evidence suggests historical profit margins are consistent with competitive market outcomes. The regulated tariff has sufficient headroom to support competitive activity and new retailers and incumbents are offering discounts. However, the smaller market size compared to electricity is likely to limit the number of retailers the market can support.

Consumers surveyed by Roy Morgan and, more recently, Newgate Research, appear broadly satisfied with their gas retailer. However, there are areas where retailers could improve their service, particularly in regards to their marketing practices and how information is conveyed.

As for electricity, competition could be further enhanced by implementing measures to support consumers and provide them with tools and information to choose an energy plan that best suits their circumstances. These measures will be discussed in more detail in the supplementary report.

We note that competition is less effective in some identifiable regional areas, where only one retailer may offer a single (regulated) gas product. Our findings suggest that this may be due to the presence of relatively low tariffs currently available and the

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121 Calculated using data from pages 8 and 13 of AGL, Appendix 4D Half Year Report for the half year ended 31 December 2012.

122 Origin, 2013 Half Year Results Announcement, 21 February 2013, p. 26.

relatively small size of the market, which makes it difficult for new retailers to enter and make a commercial return.

We note that these tariffs are likely to rise despite retail price regulation, but this should encourage entry by new retailers into these areas and the availability of lower competitive market offers.

However, if the NSW government is concerned about the level of competition in these areas it may wish to consider maintaining voluntary pricing arrangements in these specific areas until tariffs are rationalised or there is evidence of new market entry.

Until there is evidence of new entrants to this market area, the Commission considers that market monitoring, as discussed in chapter 7, should include a focus on gas consumers in regional NSW, and, in particular, the Shoalhaven area.

The Commission recommends the NSW government request AEMO to investigate whether the Shoalhaven can be covered by the same regulatory framework as other contestable areas in NSW.

The Commission notes, over the longer term, many consumers are able to substitute away from gas to electricity if there was a sustained, significant increase in the cost of gas relative to electricity. This provides additional pressure on gas retailers to maintain broadly efficient prices.

6 Impact of community service obligations on competition

6.1 Introduction

The Australian Energy Market Agreement (AEMA) requires the AEMC to consider a jurisdiction's community service obligations as part of a review into the effectiveness of competition. In particular, the AEMC must assess and report on whether a jurisdiction's social welfare and equity objectives are met through "clearly specified and transparently funded State or Territory community service obligations that do not materially impede competition".[123]

The NSW obligations, and an additional assistance program, are:

- low income household rebate;
- family energy rebate;
- medical energy rebate;
- life support energy rebate; and
- energy accounts payment assistance.

6.2 Rebates

Retailers are required to comply with the low income household rebate, the family energy rebate, the medical energy rebate, the life support energy rebate, and the energy accounts payment assistance scheme.[124] The obligations are funded by the NSW government by way of compensation for the rebate and administrative costs. The retailers are responsible for factoring the rebate into the relevant customer's bill.

The retailer must inform customers of the existence of the rebates. It must also be clear that the rebate is funded by the NSW government.

6.3 Energy accounts payment assistance

The energy accounts payment assistance operates slightly differently to the rebates. It is administered through community groups, rather than retailers. Customers may request energy accounts payment assistance vouchers from community groups. These groups assess which customers receive vouchers.

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123 AEMA, clauses 14.11(b) and c).

124 NSW Social Programs for Energy Code as adopted by clause 73 of the Electricity Supply (General) Regulation 2001 and clause 15 of the Gas Supply (General) Regulation 2001.

Each voucher is worth $50 and up to eight vouchers can be issued to one customer at one time. A customer can apply twice a year for vouchers. These vouchers can then be submitted to an energy retailer as payment. This is funded by the NSW government.

The energy accounts payment assistance is intended to help people unable or struggling to pay their electricity or gas bill due to a crisis or emergency situation.

6.4 Submissions

We note PIAC's submission recommending the NSW government undertake a review of energy customer assistance measures and implement related recommendations before removing retail price regulation.[125]

6.5 Further analysis

We note energy concessions are matters for the NSW government and consider that a review of these programs should be undertaken when considering the removal of retail price regulation to ensure they are continuing to deliver on their intended purposes in an efficient and appropriately targeted manner.

A recent report by the St. Vincent de Paul Society demonstrates that consumers could be saving up to $300 - $400 per annum by changing from the regulated rate to a market offer even if a customer routinely pays their energy bills late.[126] We note that the available savings will differ between consumers depending on consumption levels and ability to pay on time. Nonetheless, this demonstrates that consumers can save money on their energy bills by changing to competitive market contracts.

There would be benefits in the NSW government encouraging and assisting consumers who are entitled to these concession schemes to review their energy plans. By ensuring these vulnerable consumers are on the most appropriate energy plan, the NSW government may better achieve the objectives of these schemes. This will ensure that any government assistance is providing maximum benefit for these consumers and maximum efficiency for the NSW government.

This is consistent with our recommendations in the Power of Choice review that state governments review their energy concession schemes and other government assistance programs.[127]

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125 Public Interest Advocacy Centre, Draft Report submission, 5 July 2013, recommendation 15.

126 See St. Vincent de Paul Society, *New South Wales Tariff-Tracking Project*, May Mauseth Johnston, August 2013, p. 6.

127 AEMC, *Power of Choice review - giving consumers options in the way they use electricity*, Final Report, 30 November 2012, Sydney.

6.6 Conclusion

The Commission considers the five schemes above are clearly specified and transparently funded. Although the rebates can be promoted by a retailer, retailers have an obligation to indicate the rebate is funded by the state government.

This government funding is very important. If retailers had to fund a rebate by recovering additional revenue from other customers, those customers would be subsidising customers receiving rebates. Retailers may then avoid acquiring low income customers.

As the requirement to offer the rebate applies to all retailers and is transparently funded, the rebates should not distort or impede competition.

We consider the social welfare and equity objectives in New South Wales are met through clearly specified and transparently funded community service obligations that do not materially impede competition.

If retail price regulation is removed, we recommend these concession schemes be reviewed to ensure these programs are operating with maximum efficiency and effectively delivering on their intended purposes.

7 Measures further to enhance competition

Box 7.1: Summary of chapter

As discussed above, the Commission's finding is that competition is effective in the electricity and gas markets in NSW. This chapter sets out our recommendations for a package of measures to further enhance competition, including:

1. Removing price regulation. The Commission considers where competition is providing customers with a choice of energy products at efficient prices, regulated retail prices are more likely to inhibit competition than to promote it. Consequently, the Commission recommends regulated retail prices be removed for all customers at the same time. We also propose a method for transitioning away from the regulated tariff.

2. Introducing measures to provide consumers with information and support to find an energy deal that suits them. This is the subject of a supplementary report to be published at the end of October 2013. The supplementary report will provide recommendations on the key messages and best forms of communication to support as wide a group of consumers as possible, recognising that different segments of the community have different information and communication needs.

3. Ongoing market monitoring of competition in NSW and the ability to reintroduce retail price regulation if necessary.

All other regulations and protections would remain in place to support consumers if the NSW government decides to remove retail price regulation. These include obligations relating to disconnections and hardship provisions under the National Energy Customer Framework and NSW government concession schemes.

7.1 Introduction

Previous chapters in this report have set out our conclusions on the effectiveness of competition. This chapter explains our recommendation that retail price regulation should be removed in conjunction with a package of other measures to support and promote consumer choice in retail energy markets. These include:

- removing price regulation;

- providing consumers with information and support to find an energy deal that suits them (this is the subject of a supplementary report and so is not directly addressed in this chapter); and

- ongoing market monitoring of competition in NSW and the ability to reintroduce price regulation if necessary.

This chapter also summarises the important regulations and protections that currently exist and would remain in place to maintain consumer rights.

7.2 Removing price regulation

The Commission considers that, where competition is found to be providing consumers with effective outcomes, retaining price regulation is more likely to inhibit competition than promote it. This section sets out our reasons why we expect that removing retail price regulation in the NSW retail energy markets will enhance consumer choice and reduce costs and risks for retailers and ultimately consumers.

7.2.1 Benefits and costs of price regulation

Price regulation plays an important role in protecting consumers against excessive pricing arising from the exploitation of market power. The two main rationales for price regulation are:

- to act as a proxy for competition – the regulator aims to set an efficient price in the absence of effective competition in the market; and
- to prevent abuse of market power – where there is ineffective competition, customers may be unable to switch away from an unfavourable offer.

In the case of monopolies, such as electricity distribution and transmission, price regulation plays a vital role in protecting consumers. However, in sectors where competition is feasible, price regulation should be a temporary measure.

As competition develops, price regulation can become unnecessary and counteractive as competition works to protect consumers from the misuse or exploitation of market power.

Continuing with price regulation in competitive markets carries risks, including:[128]

- setting prices too high - above competitive levels;
- setting prices too low - below competitive levels;
- creating a focal point - if retailers base their market offers only in relation to regulated price, market innovation can be impeded;
- risk of tacit collusion - a regulated price may enable retailers to set a very similar market price without active collusion;

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128 Yarrow, G., *Report on the impact of maintaining price regulation*, January 2008 p. 72.

- regulatory costs and potential burden - direct costs of the regulatory body and the costs of the regulated companies associated with the regulatory process; and
- self-perpetuating - there is a risk price regulation can become a self-perpetuating system in which price regulation leads to a lack of competition, driving the need for continuing price regulation.

In the NSW energy markets, we have seen competition develop primarily in the form of discounts off the regulated tariff. While this provides some degree of choice for consumers, product differentiation is more limited than in Victoria, where price regulation was removed in 2009. For this reason we expect that removing price regulation will lead to more innovation, product choice and competitive pricing for consumers.

Historically, there have been periods where the regulated prices were set too low and new retailers have not been able to enter the market. Summarising its interviews with a number of retailers, both active retailers and those who have not yet entered the market, Sapere stated:

> "While the regulatory processes in NSW are, for the most part, viewed as sensible and transparent, the market has been alarmed by the recent events in Queensland and South Australia. These events seem to be having a negative effect on the sentiments of retailers towards jurisdictions that are not yet deregulated such as NSW. This view is particularly prevalent amongst new entrant retailers and inactive retailers."[129]

Consequently, while price regulation continues, this will always be a risk for retailers that may factor this into prices. There are also costs associated with the regulatory process for both retailers and the regulator. These costs are ultimately passed through to consumers. Maintaining price regulation in a competitive market therefore carries a number of risks and costs.

On the other hand, price regulation may provide protection for consumers not currently participating in the market because price regulation puts a limit on the prices to which they can be exposed. Currently, less than 40 per cent of electricity consumers are on a regulated tariff, and less than 30 per cent of gas consumers are on a regulated tariff. There are many reasons why these consumers may not have shifted onto a market contract.

Some consumers lack the ability or resources to engage effectively in the energy retail market. This may be due to financial stress, low income, age, disability, low literacy or English language ability. Some consumers do not participate in the market as a matter of choice.

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129 Sapere Research Group, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales - Report of Interviews with Energy Retailers*, February 2013, p. 36.

For example, they may consider the search and transaction costs to be too high, or they may consider clear, impartial information is unavailable. Consumers may also decide the possible benefits from switching do not outweigh the difficulty of finding an offer.

Without price regulation, retailers may be able to charge high prices to consumers that do not participate in the market. This can occur if retailers segment the market so the best prices are only offered to certain consumers. For example, if most retailers required customers to pay their bills by direct debit in order to qualify for discounted tariffs, those consumers who are unable or unwilling to meet this requirement may have few options.

There are a number of reasons why price regulation may not be the best way to tackle this problem. A regulated price could encourage consumers to engage less if they perceive the regulator is setting a "fair" price and therefore do not feel the need to look for a better offer. As discussed in section 4.8, evidence suggests that the regulated price is not the best price and that consumers can save by shifting onto a market contract. As a result, price regulation may lead to higher, rather than lower, prices.[130]

There are other, less intrusive ways of protecting these consumers, including through continued regulation of the non-price terms and conditions of gas and electricity retail contracts and, for those consumers who would like to switch, making it easier for them to understand and compare offers.

7.2.2 Submissions

The majority of submissions agreed with our draft conclusions that the costs of continuing to regulate retail prices outweigh the benefits.

CHOICE disagreed with our findings and submitted that competition is not sufficiently effective.[131] On this basis, CHOICE did not support removing retail price regulation.

Similarly, the Irrigators' Council submitted that it did not consider competition to be effective, particularly in rural areas for electricity consumers.[132]

PIAC did not oppose the removal of retail price regulation for electricity consumers in urban areas. However, they held concerns about the effectiveness of competition in rural and regional electricity markets and in the gas market.[133]

These submissions are addressed in the previous chapters.

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130 See Armstrong, Vickers and Zhou, *Consumer Protection and the Incentive to Become Informed*, August 2008; and Moselle, B. *An assessment of the effects of tariff regulation on the Dutch residential retail markets for energy*, June 2009.

131 CHOICE, Draft Report submission, 10 July 2013, p. 4.

132 NSWIC, Draft Report submission, p. 4.

133 Public Interest Advocacy Centre, Draft Report submission, 5 July 2013, pp. 2-4.

7.2.3 Conclusions on price regulation

Retail price regulation does offer some benefits. For example, it offers some protection for those customers who are unable to engage in the competitive retail market. However, there are a number of risks of continuing with retail price regulation where a market is competitive. A regulated retail price may discourage innovation and attempting to set the regulated price at an efficient level may lead to undesirable consequences.

The Commission's view is that where sufficient competition exists, as we find it does in NSW, the risks of regulated retail prices outweigh the benefits and regulated retail prices should be removed. The Commission therefore considers regulated retail prices should be removed.

Most consumers should be no worse off if price regulation is removed. In particular, there should be no greater risk of disconnections for consumers in hardship programs or retailer misconduct, which will continue to be regulated.

For the more than 60 per cent of electricity consumers and 70 per cent of gas consumers who are already on market contracts, there should be no discernible short-term effect of removing price regulation, and we expect there to be longer term benefits to consumers.

Consumers who do not currently engage in the market would no longer have the protection of regulated prices. We will be releasing a supplementary report in October 2013 with recommendations to help consumers access information to choose an energy plan that best suits them.

Finally, we note that a key concern about removing retail price regulation is that prices will rise as a result. There is no reason to expect that the removal of retail price regulation will, in itself, lead to higher energy prices in NSW.

It is important to distinguish between efficient cost increases and increased profit margins. Price regulation serves to keep a check on prices and ensure they do not rise above broadly cost-reflective levels. Retail prices faced by customers are made up of a number of different cost components, including wholesale energy costs, network charges and retailer operating costs and a profit margin. These costs fluctuate and are passed through by retailers to customers.

Whether retail price regulation remains in place has very little bearing on these costs. If the underlying costs increase, retail prices will also increase. Retail price regulation does not protect consumers from increases in these costs, as we have seen in the electricity market.

Where competition is effective and retail price regulation is removed, market forces should prevent retailers from charging inefficiently high prices and profit margins should approach an efficient level. Consequently, price deregulation should not expose consumers to any greater likelihood of rising prices than would otherwise occur.

7.3 Options for removing regulated retail prices

In our Draft Report, we examined options for removing regulated retail prices and their respective advantages and disadvantages. A summary is set out in the following table. Further details are available in section 7.3 of the Draft Report.

The Commission's draft recommendation was that removing regulated retail prices for all customers at the same time is the most appropriate approach as it allows all consumers equally to take advantage of the benefits of competition.

Retailers and their industry associations, including ActewAGL, AGL Energy, Alinta Energy, Australian Power and Gas, EnergyAustralia, ERM Power, the Energy Retailers Association of Australia (ERAA), the Energy Supply Association of Australia (ESAA), Lumo Energy, Origin Energy, Momentum Energy, and Simply Energy, each supported the AEMC draft finding that retail price regulation should be removed all at once for all small consumers.

PIAC also conditionally supported the "all at once" approach to removing retail price regulation for all small consumers. No other options for removing retail price regulation were proposed in submissions to the Draft Report.

The Commission continues to consider that removing regulated retail prices for all consumers at the same time is the most appropriate approach.

Table 7.1 Options to remove regulated retail prices

Option	Advantages	Disadvantages
Remove regulated retail prices for all consumers at the same time	All consumers would benefit from greater product choice at the same time	Less opportunity to develop targeted messages for different consumer segments
Remove regulated retail prices gradually by reducing thresholds	Gradual process for removal of price regulation; lower consumption users would benefit from price regulation for longer than higher consumption users	Difficulties in defining appropriate thresholds and setting boundaries
Remove regulated retail prices for different groups of consumers at different times	Would allow for a staged approach to full removal of price regulation	Costs involved in regulating retail prices for a smaller number of consumers; potential for consumer confusion
Remove regulated retail prices for all consumers at the same time, but retain some form of regulation for a sub-group	Would allow price regulation to be directed to a particular group	Difficulty involved in accurately setting the price differential between groups
Allow consumers to opt-in to a regulated retail price	Provides some protection for consumers not able to benefit from competition and who choose regulated pricing	Consumers likely to benefit most from a regulated price are not active in the market and rely on the regulated tariff

7.4 Transitioning from regulated retail pricing

If regulated retail prices are removed, it is likely a significant proportion of consumers would be on regulated tariffs at the time of deregulation. This section considers how these consumers could be transitioned off the regulated tariffs onto a retailer's default (standing offer) tariff.

Should the NSW government decide to remove regulated retail prices, all retailers will be required to publish a "standing offer" price that is effectively the default price the retailer will charge if a customer does not choose a market offer.[134] This standing offer is unregulated. Consequently, the regulated price will effectively be replaced by a standing offer not subject to price regulation.

The Commission considers that an intermediate step is needed during the transition phase from the regulated price to standing offers. The purpose of this step is to commence the process of removing price regulation and signal to consumers that changes are occurring while providing them with protection for a period.

The Commission therefore recommends that consumers on the regulated price should first be transitioned onto a "fixed standing offer" tariff. The terms and conditions for this transitional tariff, including price, should be fixed for a period, such as a year. The price set under the latest IPART determination, for example, could be the fixed standing offer in this transition process.

Table 7.2 Explanation of tariffs for the transitional process

Regulated price (current arrangement)	Fixed standing offer (transitional tariff)	Standing offer (no regulated retail prices)
• Regulated retailers required to offer this tariff • Price regulated by IPART	• Regulated retailers required to offer this tariff • Price carried over from IPART determination; fixed for a period	• All retailers required to make standing offer available as default tariff under the National Energy Retail Law • Price determined by retailers

Once the defined period has elapsed, retailers would be able to alter the terms and conditions of the standing offer, including price, subject to any legal or regulatory constraints. For example, under the NECF retailers are required to publish a notice of their standing offer prices one month in advance. Limitations are also placed on a retailer's ability to change the price of its standing offer contract more frequently than six monthly.

134 National Energy Retail Law (NSW) 2012, s. 22.

It would be desirable to introduce measures to provide consumers with information and support to find an appropriate energy deal prior to the regulated tariff changing to a fixed standing offer tariff. This would allow consumers time to understand how they can benefit from changing retailers and to provide them with the information and tools to do so.

7.5 Market and price monitoring and reregulation

Removing regulated retail prices where competition is effective should deliver benefits to consumers. However, it is not possible to predict with certainty what the specific outcomes will be in the context of a particular market.

Therefore, whatever path to removing regulated retail prices is adopted, the Commission recommends ensuring an appropriate level of market monitoring is in place and that the NSW government has the ability to reintroduce price regulation.

7.5.1 Market monitoring

If regulated retail prices are removed, it will be important to monitor the effectiveness of competition, to assess trends in the development of the market, and to provide information on the market to relevant stakeholders.

Such monitoring, including the prices consumers pay, should help to inform the NSW government on whether there is a need to investigate further the effectiveness of competition in the retail energy markets.

In our Draft Report we considered the types of variables that might be monitored and which agency may be best placed to undertake the monitoring.

Submissions

In their respective submissions to the Draft Report, both PIAC[135] and CHOICE[136] submitted that price monitoring should include examination of revenues and margins for all tariffs and plans.

PIAC also submitted the proposed monitoring should include energy affordability as measured by rate of disconnections and suggested that sustained profit margins above a certain level for larger retailers should be a trigger for reregulation.

CHOICE also considered a number of consumer-based variables should be monitored, such as "the level of confidence that consumers have that…they can easily choose the best plan".[137]

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135 Public Interest Advocacy Centre, Draft Report submission, 5 July 2013. pp. 6-9, 16.

136 CHOICE, Draft Report submission, 10 July 2013, p. 6.

137 Ibid.

The AER agreed that monitoring arrangements should be established if retail price regulation is removed.[138] AER expressed a willingness to take on this role with assistance from IPART.

The ERAA,[139] Origin Energy,[140] and AGL Energy[141] each submitted their support for the AEMC's proposed market monitoring should retail price regulation be removed. However, each submitter objected to the monitoring of retailers' revenues or margins. The submitters variously suggested that such measures are inexact and presuppose an 'acceptable' level of margin or revenue, beyond which punitive action should be taken.

The ERAA also submitted that the proposed monitoring regime be phased out unless it proves to be of net benefit to consumers.[142]

ActewAGL considers monitoring may be an unnecessary and costly process, and noted transitional regulation has been in place for 11 years.[143] ActewAGL submitted that if monitoring is implemented, it be for a limited period as interpreted from clause 14.14 of the Australian Energy Market Agreement.[144]

AP&G submits that monitoring is appropriate for a short term to gauge the effectiveness of the removal of retail price regulation.[145]

EnergyAustralia submitted its general support of the proposed monitoring.[146]

Simply Energy submitted that it supports ongoing monitoring using price and non-price indicators and suggests guidance may be needed around the required information to decrease the regulatory burden and also submits that the period of monitoring be limited.[147]

The NSW Energy and Water Ombudsman (EWON) broadly submitted its support for the monitoring proposals to monitor effectiveness of competition in the energy markets.[148]

Conclusions

The Commission considers that market monitoring is necessary, particularly in the transition phase, should the NSW government decide to remove price regulation. We

138 Australian Energy Regulator, Draft Report submission, 4 July 2013, pp. 1-2.

139 Energy Retailers Association of Australia, Draft Report submission, 5 July 2013, p. 3.

140 Origin Energy, Draft Report submission, 5 July 2013, p. 4.

141 AGL Energy, Draft Report submission, 8 July 2013, pp. 2-3.

142 Energy Retailers Association of Australia, Draft Report submission, 5 July 2013, pp. 2-3.

143 ActewAGL, Draft Report submission, 5 July 2013, p. 1.

144 Ibid.

145 Australian Power & Gas, Draft Report submission, 5 July 2013, p. 1.

146 EnergyAustralia, Draft Report submission, 5 July 2013, p. 2.

147 Simply Energy, Draft Report submission, 5 July 2013, p. 1.

148 EWON (NSW), Draft Report submission, 4 July 2013, pp. 2-3.

note that the AEMC and the AER already have, or will have from 2014, a number of NEM-wide market monitoring functions. We consider these processes are sufficient and that it would be unnecessarily duplicative to produce a specific market monitoring report limited to NSW.

On 7 December 2012, the Council of Australian Governments (COAG) agreed that the SCER will develop any necessary enhancements to the AEMC competition review approach, incorporating, where provided, advice from the AEMC as previously requested and taking into account any advice from the AEMC's review of competition in NSW, and including proposals to COAG for Australian Energy Market Agreement (AEMA) amendments, by 2013 with any new approach to be applied annually thereafter.

Over the first half of 2013, the SCER developed and approved a revised approach to the AEMC's competition reviews. This includes Terms of Reference and amendments to the AEMA to guide the AEMC. The SCER presented the amended AEMA to COAG for its approval on 9 May 2013. Subject to approval by COAG, the SCER intends to request the AEMC apply the new approach with a first report in 2014.

The main change under the revised approach is that these reviews will no longer focus on a single jurisdiction, but will instead provide an annual assessment of the state of competition in each jurisdiction across the NEM.

Should the Terms of Reference be approved, the AEMC considers it is likely to apply similar criteria to the assessment that are currently specified under the Statement of Approach for competition reviews. Jurisdictions will also be able to request a more in-depth review of their own jurisdiction if the NEM-wide annual review raises issues that warrant further investigation.

The Commission considers that these ongoing annual reports provide an appropriate level of market monitoring should the NSW government decide to remove retail price regulation. By leveraging off existing processes, this option removes the need for a separate, largely duplicative report if another agency were required to undertake the ongoing market and price monitoring role.

As discussed in chapter 5, we consider this market monitoring should include a specific section on gas pricing trends in regional areas that are currently subject to less effective competition.

This annual report will also be able to draw from the AEMC's existing obligations to report annually on NEM-wide retail electricity pricing trends.

The National Energy Retail Law requires the AER to publish a retail market performance report each year.[149] The National Energy Retail Rules, at Part 10, require these reports to include:

149 National Electricity Retail Law, sections 284-285.

- statement of the number of retailers and the number of retailers actively selling energy to customers;
- indication of the number of customers of each retailer;
- indication of the total number of customers on standard retail contracts and market retail contracts, and the numbers by reference to each retailer;
- indication of the numbers of customers who have transferred from one retailer to another retailer;
- information on customer service and customer complaints; and
- a report on energy affordability for small consumers.

This report will also provide a valuable resource to inform market monitoring in NSW if regulated retail prices are removed.

We note the additional indicators proposed by PIAC. In respect of disconnections, the Commission considers that energy affordability is not a measure of the competitiveness of a market. Rather, disconnections are regulated, and should be monitored, under the NECF.

In regards to profit margins as a trigger for reregulation, we note it is very difficult accurately to measure profit margins or define what an appropriate margin may be. Businesses have different cost structures and strategies and so may require different rates of return for their investments.

Further, profit margins are not a stable indicator. As costs and risks vary over time, so too will profit margins. Consequently, while they provide an indicator of competition and may be considered in the AEMC's annual competition reviews, they are not in themselves determinative.

In respect of CHOICE’s proposal to monitor consumer-focussed indicators, these issues are discussed more broadly in our supplementary report.

7.5.2 Framework for reintroducing price regulation

Due to uncertainty over how the market will develop following price deregulation, the ability to reintroduce retail price regulation should be retained. Retaining this ability would provide protection if competition were to become ineffective. In addition, this may incentivise good market conduct by retailers.

The main concern with maintaining the ability to reintroduce price regulation is the uncertainty it may create for retailers and the potential it has to undermine investment or deter new retailers from entering the market.

Victoria and South Australia have each retained a framework to reintroduce price regulation.[150] We understand the South Australian approach to ending price regulation was done by not bringing into operation those provisions of the National Energy Retail Law (South Australia) 2011 that required a retailer's standing offer under the National Energy Retail Law to be in accordance with local price regulation. The price regulation framework in this state remains in place.

The Victorian approach to reintroducing price regulation is structured in a way that the Essential Services Commission of Victoria has the power to regulate tariffs if an order has been made through that State's Governor in Council. However, such an order can only be made if, under a Ministerial Council on Energy (MCE) directed competition review, the AEMC concludes that competition in a market for electricity is not effective and recommends price regulation be reintroduced.

We consider that if regulated retail prices are removed in NSW, the NSW government should retain the ability to reintroduce retail price regulation. With the adoption of the National Energy Retail Law on 1 July 2013,[151] NSW ensured that regulated prices would continue to be offered to small consumers.[152]

We note the Victorian approach to the potential reintroduction of price regulation strikes an appropriate balance between providing some protection against ineffective competition whilst providing regulatory transparency and certainty to market participants. Importantly, it also allows for a thorough investigation of the state of competition in the market and for alternative mechanisms to be explored for improving the effectiveness of competition before resorting to reregulation. This approach would require legislative change to be implemented in NSW.

As discussed above, the revised approach to the AEMC's competition reviews provides a framework for this approach to be implemented since it allows jurisdictions to request a more in-depth review of their own jurisdiction if the NEM-wide annual review raises issues that warrant further investigation.

If the NSW government decides to remove price regulation, and does not retain a framework for reregulation, the government will, of course, retain the power to reintroduce price regulation at any time by legislation.

7.6 Continuing consumer protections

While we are recommending the NSW government remove retail price regulation, there are many other regulations and protections that are currently operating that will continue to provide consumers with a safety net. These include:

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150 We note the AEMA has provision for regulated retail prices to be reintroduced following their removal.

151 National Energy Retail Law (Adoption) Act 2013.

152 By modifying the operation of the National Energy Retail Law to create a new category of regulated consumer. This category of consumer operates in tandem with the small consumer category established by the National Energy Retail Law.

- the National Energy Customer Framework (NECF);
- modifications to the NECF adopted by the NSW government (eg, early termination fees and hardship policies);
- oversight by the ACCC; and
- the Australian Consumer Law.

An important part of our supplementary report will include advice on how consumers can best be made aware of these protections so they understand their rights when participating in energy retail markets.

7.6.1 The National Energy Customer Framework

The NECF aims to harmonise state-based regulatory frameworks (excluding retail price regulation and community service obligations) for energy distribution and retail into a single set of national rules.[153] The NECF was designed to provide a suitable consumer protection framework whether or not retail prices are regulated. Importantly, these protections will remain in place should the NSW government decide to remove regulated retail prices.

The NECF contains a range of energy-specific consumer protections, including:

- rules relating to retailers collecting security deposits from new customers;
- rules relating to retailers imposing late payment fees on small consumers' bills;
- requiring energy retailers to develop, maintain and implement a customer hardship policy for residential customers;
- an obligation on specified retailers to offer a standing offer contract to customers if requested;
- requiring retailers to publish their standing offer prices one month in advance and provide customers with detailed information on prices and terms and conditions at the point of sale;
- a limitation on retailers' ability to change the price of their standing offer contracts more frequently than six monthly; and
- an obligation on retailers to provide details of their generally available offers to the independent price comparator website(s) (operated by the AER).

The NECF commenced in NSW on 1 July 2013.

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153 The Framework includes the National Energy Retail Law and the National Energy Retail Rules, which were passed in the South Australian Parliament on 9 March 2011 and received Royal Assent on 17 March 2011.

Protections for consumers experiencing hardship

Consumers experiencing hardship are those who have difficulty paying their bills due to financial stress. The NECF requires each authorised energy retailer to develop, maintain and implement a customer hardship policy for their residential customers. The AER approves hardship policies for retailers, which are required to contain a number of provisions, including:

- processes to identify customers experiencing payment difficulties due to hardship;
- processes for the early response by the retailer to residential customers experiencing payment difficulties due to hardship;
- flexible payment options for payment of energy bills by customers experiencing hardship;
- processes to identify government concession programs and financial counselling services and to notify customers experiencing hardship of those programs and services;
- processes to review the appropriateness of market retail contracts for customers experiencing hardship, in accordance with the purpose of the customer hardship policy; and
- processes or programs to assist customers to improve their energy efficiency.

The protection provided by the NECF exists independently of retail price regulation. These protections will continue even if regulated retail prices are removed.

7.6.2 Additional measures adopted by the NSW government

In implementing NECF, the NSW government chose to provide some additional protections to consumers that will continue should regulated retail prices be removed. These policies are specific to NSW and are modifications to the national NECF requirements.

For example, under the national NECF, retailers are banned from imposing late fees on hardship customers. The NSW government has also adopted a new policy complementing this ban by specifying instances that may indicate a customer is experiencing hardship.[154]

Late payment fees are currently regulated by IPART in electricity. In the current regulatory period (2013-2016), IPART set the maximum late fee that may be charged at $10.90. If price deregulation occurs, IPART may no longer regulate such fees.

154 See clause 10 of the National Energy Retail Law (Adoption) Regulation 2013 (NSW).

Under the NSW NECF modifications, limits are imposed on who can be charged early termination fees and allows a cap to be imposed. The NSW government has recently asked IPART to investigate and report on requirements in relation to early termination fees. IPART is advising on the appropriate cap for early termination fees for all fixed term electricity contracts in NSW. This cap is expected to commence on 1 March 2014.

Under the NERL,[155] early termination charges cannot be imposed unless the charge is included in the relevant contract and is a reasonable estimate of the costs to the retailer resulting from the early termination.[156]

7.6.3 Investigations into energy retailer conduct by the ACCC

The ACCC recently named energy consumer issues as one of their priorities. Unfair sales practices relating to door-to-door selling and promotions, which can mislead consumers by offering discounts off an uncertain base, were singled out as investigative and enforcement priorities.

Recent ACCC actions against retailers involved in door-to-door energy sales resulted in significant monetary orders against energy retailers for illegal door-to-door sales practices. Some proceedings remain on foot in this area. We note that since these ACCC enforcement actions, the three largest energy retailers have discontinued, or expressed their intention to discontinue, door-to-door marketing activities.

The ACCC has noted that with the ending of door-to-door marketing, there has been an increase in related tele-marketing activities.[157] The ACCC also indicated it will be equally concerned about false or misleading representations made via this marketing channel.

The ACCC has also indicated that its next area of focus on consumer issues in the energy sector concerns misleading discount claims relating to the promotion of discounts and savings off energy use and/or supply charges under those plans. In other words, 'discounts off what?'.

While contract terms may state that the "fix" relates only to a percentage discount off a variable price, there is avoidable consumer confusion about what is "fixed" in a fixed term contract. The ACCC acknowledges that it can be a difficult and complex process to choose an energy tariff.[158]

The ACCC has also raised concerns with a number of firms operating online energy price comparison services following court proceedings last year against a firm found to

155 We note that while these arrangements are currently due to come into effect on 1 January 2014, the NSW Department of Trade & Investment has advised IPART that the regulations will be updated to commence on 1 March 2014. See IPART Issues Paper, *Review of requirements for early termination fees*, August 2013, note 3. Available at www.ipart.nsw.gov.au.

156 See Rule 49A of the National Energy Retail Rules.

157 ACCC, Delia Rickard, Deputy Chair, *Creating an affordable, secure and sustainable energy market*, 27 June 2013. Available at www.accc.gov.au/media/speeches.

158 ACCC media release, *Discount off what? Energy plan promotions a concern*, 27 June 2013.

be misleading consumers about its price comparison service and the savings that could be achieved. As a result of these findings, the ACCC was concerned that other online energy price comparison firms were engaging in similar conduct. This remains an issue that the ACCC is actively focussed on.

7.6.4 Australian Consumer Law

The Australian Consumer Law[159] (ACL) provides protections for consumers of retail energy services. The ACL applies nationally and in all States and Territories, and to all Australian businesses. This law provides many relevant consumer protections, including regulating:

- unfair contract terms law covering standard form consumer contracts;
- guaranteeing consumer rights when buying goods and services; and
- unsolicited consumer agreements covering door-to-door sales and telephone sales.

We note that the new unfair contract provisions of the ACL were recently the subject of a Federal Court declaration that found the unilateral variation of a price under an existing contract without providing the customer with a right to terminate the contract was an unfair contract term. The Court considered this and other terms of the contract unfair because they created a significant imbalance in the parties' rights and obligations and were not reasonably necessary to protect the firm's legitimate interests.[160]

The ACL provides a further tool to protect consumers from unfair contract terms and to guard consumers' rights against unscrupulous practices. The ACL broadens the base for existing and ongoing consumer protection measures; this will not change regardless of whether retail price regulation is removed in NSW.

7.7 Conclusions

The Commission has found that competition is effective in both the electricity and gas retail markets. The Commission considers that competition can be further enhanced to provide consumers with greater product choice by introducing a package of measures.

First, the Commission recommends that retail price regulation be removed. The Commission considers where competition is providing consumers with a choice of energy products and efficient prices, price regulation is more likely to inhibit competition than promote it.

159 The ACL is found in Schedule 2 of the Competition and Consumer Act 2010 (Cth).

160 See ACCC media release in this matter here: www.accc.gov.au/media-release/court-declares-consumer-contract-terms-unfair.

Consequently, having found competition to be effective in providing these outcomes, the Commission recommends regulated retail prices in electricity and gas be removed. Consumers should benefit from increased product choice and innovation following the removal of retail price regulation.

There are currently a few specific areas in regional NSW where gas consumers have more limited choice of their retailer. The Commission considers that removing retail price regulation will enhance competition in these areas.

The Commission recommends regulated retail prices should be removed for all consumers at the same time so that all consumers are able to benefit from greater product choice at the same time. Further, there should be a transition period whereby consumers are shifted off the regulated price but still retain some pricing protection for a period of time to allow consumers time to understand how they can benefit from changing retailers and to provide them with the information and tools to do so.

Second, the Commission recommends that measures be introduced to provide consumers with information and support to find an energy deal that suits their needs. There may be some consumers who are less likely to capture the benefits of competition and may not be better off if regulated retail prices are removed; namely, consumers who do not currently participate in the competitive market.

It needs to be made easier for those consumers who would like to switch retailers or change energy plans to understand and compare offers. This is the subject of a supplementary report to be published in October 2013.

Third, the Commission recommends ongoing market monitoring of competition in NSW. We further recommend that this be undertaken by the AEMC as part of its revised annual, NEM-wide approach to competition reviews.

The NSW government always has the ability to reregulate prices through legislation. The NSW government way wish to consider introducing an approach whereby a decision to reregulate is subject to an in-depth review of the state of competition by the AEMC.

Finally, we note that the existing regulations and protections for consumers would continue to have effect in the absence of a regulated retail price. The NECF, additional measures adopted by the NSW government, oversight by the ACCC, and the ACL together work to provide consumers with the protections they need to participate in the market.

An important part of our supplementary report will be advice on how consumers can best be made aware of these protections so they understand their rights when participating in energy retail markets.

A Submissions

Market definition

Stakeholder	Issue/Comment	AEMC response
EnergyAustralia	Is comfortable with the Commission's market definition, that there are no sub-markets within NSW, and that small business and residential consumers are in the same market. (p. 3)	The market definition has changed from the draft report. A full explanation for this change is provided in chapter 3.
NSW Irrigators' Council	Noted concerns about unequal levels of competition in the NSW electricity market. Submits its members have experienced significant electricity price increases over the last ten years and notes that because supply charges have been the largest driver in price rises, it does not see how the removal of price regulation will benefit consumers. (p. 4)	The AEMC notes that retail price regulation has not protected consumers from price rises due to increases in network costs. However, we consider that competition in the retail supply component will maintain downward pressure on retail prices. The AEMC presents additional analysis between regional and urban areas in section 4.4 and discusses the benefits of removing price regulation in section 7.2.
Origin Energy	Supports the AEMC draft definition of the electricity and dual fuel markets. Also supports AEMC draft decision to set the geographic scope of the markets as the state of NSW. (p. 7)	Noted.
PIAC	Does not agree with gas being considered part of a dual fuel market because: (1) costs associated with switching appliances from gas to electricity affect the extent to which switching can occur, in particular for those consumers who live in rental properties; (2) consumers can choose to purchase gas and electricity from the same retailer or different retailers; and (3) some consumers have limited access to market offers for gas, particularly those consumers who live in regional areas. (pp. 3-4)	The AEMC has revised its market definition, as set out in chapter 3.

Effectiveness of competition

Stakeholder	Issue/Comment	AEMC response
ActewAGL	Supports the Commission's draft finding that competition is effective in the NSW electricity and dual fuel markets. (p. 1)	Noted.
AGL Energy	Supports the Commission's draft findings that competition in the retail electricity and gas markets in NSW is effective and is delivering benefits to consumers. Notes that it has not found the way in which it interfaces with gas distribution networks in NSW to be a significant barrier to entry or expansion. (p. 1)	Noted.
Alinta Energy	Agrees with AEMC's draft recommendation that removing price caps for all consumers at the same time is the most appropriate approach. Notes it is yet to enter the NSW mass market, and submits that the current regulated retail price is not set at levels that recognise the forward risk faced by new entrant retailers. (pp. 1-2)	Noted.
Australian Power & Gas	Supports AEMC draft finding that competition in the NSW electricity and gas markets is delivering benefits to consumers. (p. 1)	Noted.
CHOICE	Disagrees with AEMC draft finding that the NSW small consumer retail electricity and gas markets are effectively competitive. Notes if the AEMC determines competition is sufficient to remove price caps, there is no guarantee it will remain the same or improve. (pp. 4-5)	Noted. The AEMC discusses further analysis of the electricity and natural gas markets since publication of the draft report in sections 4.4 and 5.4.
EnergyAustralia	Supports the Commission's draft findings that competition in the small customer gas and electricity markets is effective. (p. 1)	Noted.
Energy Retailers Association of Australia	Supports AEMC draft findings and agrees competition in the NSW retail markets for electricity and gas is effective. (p. 1)	Noted.
Energy Supply Association of	Welcomes AEMC draft finding that there is sufficient competition to remove retail	Noted.

Stakeholder	Issue/Comment	AEMC response
Australia	energy price regulation in NSW. (p. 1)	
ERM Power	Supports Commission's conclusions about the positive state of energy retail competition and draft recommendation that price regulation be replaced with price monitoring. (p. 1)	Noted.
IPART	Considers competition is effective enough to provide sufficient protection to consumers. Notes the removal of price regulation is likely to improve consumer engagement as it will reduce confusion in relation to differences in price types and risks of regulation distorting the competitive market. (pp. 1-2)	Noted.
Jemena	Notes the business-to-business processes allow retailers to commence operations with rudimentary systems and increase automation. Does not consider this approach is a barrier to entry in the gas retail market. Submits national procedures have potential to reduce cost in NSW/ACT markets. Notes AEMO cost benefit analysis found the costs of harmonisation would outweigh benefits. Further notes it is exploring options to optimise / harmonise using different specifications. (pp. 1-3)	Noted.
Lumo Energy	Supports the Commission's draft recommendation for the removal of price caps in NSW. Considers the removal of price regulation is in the long term interests of consumers through increased competition and choice. (p. 1)	Noted.
Momentum Energy	Agrees with the AEMC that competition in the NSW retail markets for electricity and gas is effective and is benefiting consumers. Notes first tier retailers have a combined market share in electricity (95 per cent) and gas (98 per cent) that constrains the extent to which the current level of competition can be enhanced. Further notes this level of market concentration is unlikely to change significantly without the removal of price regulation. Reiterates its concern that there are significant barriers to entering the NSW retail gas market and these barriers are impeding new entrant activity into dual fuel. Notes this issue is best addressed through alternative processes and should not hold up the removal of gas retail price regulation. (pp. 1-2)	Noted. The AEMC has recommended the removal of retail price regulation and other measures to enhance competition, as discussed in chapter 7. There do appear to be some barriers to entering the NSW gas market compared to electricity; however, new retailers have entered both markets.

Stakeholder	Issue/Comment	AEMC response
Origin Energy	Supports AEMC draft finding that competition in the retail supply of electricity and gas is effective and notes barriers to entry and exit are low in these markets. Notes price regulation remains a residual barrier to entry in NSW. Agrees that the removal of retail price regulation is likely to lead to an increase in the diversity of products. Notes AEMC draft findings that only a small proportion of electricity and gas consumers who change retailers in NSW do so because of a negative retail experience. Suggests NECF will improve outcomes in customer experience and notes Origin Energy will cease door-to-door marketing activities. (pp. 3, 8-9)	Noted.
PIAC	Submits there is considerable uncertainty in the gas market due to changes in the wholesale market. Notes IPART decision not to make a determination for price changes for more than one year because of these uncertainties. Reiterates submission to Issues Paper that gas market is not competitive. Recommends price regulation be retained for gas. (p. 4)	The AEMC considers the market is better placed to adjust to uncertainty than a regulator. This is discussed further in section 5.4.1.

Path to removing price regulation

Stakeholder	Issue/Comment	AEMC response
ActewAGL	Agrees retail price caps should be removed for all consumers at the same time. Supports Commission's draft recommendation that a reserve framework to reintroduce price regulation should be retained if price regulation is removed. Notes the causes for market related concerns must be well understood prior to such intervention. Suggests proposed market monitoring be scrutinised to avoid unnecessary costs and argues such monitoring be only for a period in accordance with the AEMA. (p. 1)	Noted.
AGL Energy	Strongly supports the Commission's draft recommendation that retail price regulation be removed for all consumers at the same time and notes the Commission's recognition that the removal of price regulation is likely to improve the development of the market. Recommends guidance should be taken from Victoria and South Australia in structuring an effective transition to the removal of retail price regulation in NSW. Recognises the benefits that price and market monitoring would have following the removal of retail price regulation. Considers it would be sensible for the AER to perform the market monitoring role under NECF and for IPART to perform a price monitoring function. However, disagrees with suggestion to monitor retailer revenues or margins. Notes such monitoring would go beyond the level of regulatory scrutiny that currently exists in which prices are regulated. Agrees with AEMC draft recommendation that there be a reserve power to reregulate retail energy prices in the event competition were to become ineffective. Notes the necessity that such a power be used as a last resort, is transparent, and involves objective criteria prescribing when it could be exercised. Recommends such a power should only be able to be exercised in the clear case of sustained market failure in which competition becomes ineffective. Considers the arrangements in Victoria in this regard should be used as a guide for NSW. Notes it does not agree with AEMC draft suggestion that a possible trigger for reregulation could be a reduction in switching rates to less than 10 per cent over a 12 month period. Considers a recommendation for reregulation should only be made by the Commission. (pp. 1-3)	Noted. The AEMC sets out its recommendations on market monitoring and reregulation, and the accompanying reasons, in section 7.5.

Stakeholder	Issue/Comment	AEMC response
AGL Energy	Suggests that rather than retaining price regulation once a market is competitive, it is most effective for governments to deploy resources aimed at ensuring retailers and social welfare agencies have appropriate information to encourage vulnerable households to adopt the best tariff for their particular circumstances. (pp. 1-2)	Noted. The AEMC recommends the removal of price regulation as part of a package of measures to enhance competition, as discussed in chapter 7, including providing information support, which will be considered in detail in the supplementary report to be released in October 2013.
Australian Energy Regulator	Agrees with the AEMC that proposed market monitoring should be implemented if price regulation is removed. Notes AEMC analysis appears to raise some issues with existing retail markets in NSW (relating to high market concentration and limited product differentiation). (pp. 2-3)	Noted. The AEMC discusses further analysis of the electricity and natural gas markets since publication of the draft report in sections 4.4 and 5.4.
Australian Power & Gas	Supports the AEMC draft recommendation to remove price regulation for retail electricity and gas in NSW. Considers the removal of price regulation will further promote competition by allowing retailers to innovate on price and product offerings. Notes uncertainty created by price regulation does not allow for retailers to make adequate investment in the market to allow such product innovation to occur. Agrees with AEMC draft recommendation to remove price regulation all at once, rather than in a staged manner. Agrees with AEMC that some form of price monitoring is appropriate in the short term to allow for close monitoring of the effectiveness of competition. Does not support inclusion of an automatic reregulation trigger. (pp. 1-2)	Noted.
CHOICE	If price regulation is removed, recommends additional market monitoring measures: retailer revenues and margins for time-of-use plans, flat tariffs, standing offers and market offers; level of confidence consumers have based on the criteria they are applying when choosing between plans; and the level of intention that consumers have to examine available offers in the next few years. Proposes annual consumer surveys. (pp. 6-7)	Noted. The AEMC has recommended market monitoring in place of retail price regulation, and a number of other measures to enhance competition, as discussed in chapter 7.
EnergyAustralia	Supports the Commission's draft recommendation that price regulation should be removed for all small consumers of gas and electricity in NSW. Agrees with AEMC that the removal of price regulation for all groups at the same times is the	Noted. The AEMC sets out its recommendations on market monitoring and reregulation, and the accompanying reasons, in section 7.5.

Stakeholder	Issue/Comment	AEMC response
	most effective approach. If price regulation is removed, supports the use of market monitoring to inform the government of whether there is a need to investigate further the effectiveness of competition. Notes the NSW government retains legislative power to reregulate prices. Does not support specific reregulation triggers being built into the system. Suggests that if there are concerns in the future about the level of competition, a review should be required to be conducted into the state of competition after a minimum period following the removal of price deregulation. Notes such a review should consider what alternative measures are available to improve competition before consideration is given to reintroducing price regulation. (pp. 3-4)	
Energy Retailers Association of Australia	Supports the AEMC draft recommendation for the removal of price regulation. Notes retail energy price regulation does not apply to almost any other contestable good or service. Supports AEMC draft recommendation to remove retail price regulation for all small consumers at the same time. Notes market monitoring should be implemented to inform government of the effectiveness of competition if price regulation is removed, but suggests market monitoring is phased out unless it is proven to be of net benefit. Does not consider monitoring of revenues or margins is necessary if price regulation is removed, suggesting it would be an unnecessary cost and add little value to the monitoring of competition. (pp. 1-2)	Noted. The AEMC sets out its recommendations on market monitoring, and the accompanying reasons, in section 7.5.
Energy Supply Association of Australia	Agrees with the AEMC draft recommendation to remove price regulation across the state and simultaneously. Disagrees with AEMC draft view that it would be desirable to have additional "measures to encourage customers to engage in the market and support them to make effective choices" prior to the removal of price regulation. Recommends the removal of price regulation be implemented shortly after the NSW government receives the AEMC final report. Recommends before moving to reregulate the market, there be a requirement to conduct a short independent inquiry to establish the state of competition and whether there are other options to facilitate competition. (p. 1)	Noted. The contents of and timing of additional measures to encourage consumer participation will be included in the Supplementary Report, to be released in October 2013.

Stakeholder	Issue/Comment	AEMC response
Energy Supply Association of Australia	Does not support AEMC draft recommendation to include reregulation triggers. Notes government can reregulate by legislation at any time and considers the presence of specific triggers could drive reregulation, even where it is not required. Recommends before moving to reregulate the market, there be a requirement to conduct a short independent inquiry to establish the state of competition and whether there are other options to facilitate competition. (p. 4)	Noted. The AEMC sets out its recommendations on reregulation, and the accompanying reasons, in section 7.5.
Energy & Water Ombudsman NSW (EWON)	Submits that the process of removing price caps must be transparent and consistent. Encourages the AEMC to provide a definite indication of how long a proposed transitional tariff will be in effect. Supports AEMC comment that key contract conditions, such as early termination and late payment fees, may deserve further regulatory attention in ensuring they are not overly restrictive and work to deter or prevent full consumer participation in the market. Suggests the needs of consumers experiencing financial hardship and who are on standard retail contracts must be considered when removing price caps. Supports AEMC recommendation to monitor the effectiveness of competition in the energy markets. Supports AEMC comment that key contract conditions, such as early termination and late payment fees, may deserve further regulatory attention in ensuring they are not overly restrictive and work to deter or prevent full consumer participation in the market. (pp. 1-2)	Noted. The AEMC has recommended the removal of retail price regulation and other measures to enhance competition, as discussed in chapter 7. The timing of any transitional tariffs is an issue for the NSW government to consider.
ERM Power	Agrees with the AEMC's draft recommendation that removing price caps for all consumers at the same time is the most appropriate approach. (pp. 2-3)	Noted.
IPART	Recommends the NSW government review arrangements for residential parks and affordability measures. Notes support for AEMC consideration of transitional arrangements and improvements to consumer engagement, market monitoring, and information disclosure. (pp. 2-3)	Noted. The Commission discusses the impact of community service obligations on competition in chapter 6. Any review of consumer assistance measures or arrangements for residential parks is a matter for the NSW Government.
Lumo Energy	Notes any AEMC recommendations in relation to additional consumer protections be made through the NECF so consumers in all jurisdictions may benefit from these protections and the regulatory burden is minimised. (pp. 1-2)	Noted. The AEMC has recommended a continuation of existing consumer protections, as discussed in section 7.6.

Stakeholder	Issue/Comment	AEMC response
Momentum Energy	Notes the AEMC draft recommendation to remove price caps is underpinned by a strong case for the removal of price regulation, which should provide the NSW government with confidence that the removal of price regulation is consistent with the National Electricity Objective of being in the long term interest of consumers. Suggests the NSW retail electricity and gas markets will become more attractive to Momentum Energy if clear direction is set by the AEMC and NSW government on phasing out retail price regulation. Notes a partial, geographic removal of price regulation would be perceived as being less attractive to new entrants and result in less competitive outcomes. Suggests it is appropriate to remove price regulation for all NSW consumers at the same time, noting other mechanisms to support specific customer groups can be introduced if necessary. Considers the most appropriate determinant for any reintroduction of retail price regulation to be a comprehensive review process, rather than a specific metric. (p. 1)	Noted.
NSW Irrigators' Council	Notes competition between urban and rural NSW remains unequal and does not agree with AEMC draft finding that price regulation should be removed uniformly across the state. (p. 4)	Noted. The AEMC discusses further analysis of the electricity and natural gas markets since publication of the draft report in sections 4.4 and 5.4.
Origin Energy	Agrees with the AEMC draft finding that retail price regulation of all small residential and business consumers should be removed simultaneously. (p. 2)	Noted.
Origin Energy	Supports the AEMC proposed monitoring measures, except revenue and margin monitoring, as they are unnecessary and ineffective. Notes all indicators proposed can be monitored under the NECF, with the exception of revenue and margin monitoring which suggests that policymakers did not foresee the monitoring of revenue and margins when establishing the retail customer framework. (pp. 14-15)	Noted. The AEMC sets out its recommendations on market monitoring, and the accompanying reasons, in section 7.5.
PIAC	Conditionally agrees with the AEMC's draft recommendation that removing price caps for all consumers at the same time is the preferable approach should the NSW government decide to remove price regulation. (pp. 2-3)	Noted.

Stakeholder	Issue/Comment	AEMC response
PIAC	Submits that given the high awareness of consumers' ability to choose market offers, yet 40% of customers remain on regulated contracts, implies many consumers are choosing not to move onto market contracts because they value the simpler, legislated contract terms of the regulated tariff. Recommends if price regulation is removed, retailers be required to have standing offers available to all retail customers and publish price changes only twice a year. (pp. 5-6)	Noted. The AEMC considers these matters in detail in the supplementary report to be released in October 2013.
PIAC	Recommend a comprehensive framework for market monitoring and triggers for reregulation should be established if prices caps are removed. Recommends banning late payment and early termination fees. (pp. 7-12)	Noted. The AEMC has recommended the removal of retail price regulation and other measures to enhance competition, as discussed in chapter 7.
PIAC	Recommends a review of all energy customer assistance measures and the implementation of such recommendations prior to removal of price regulation. (p. 16)	The Commission discusses the impact of community service obligations on competition in chapter 6. Any further consideration of consumer assistance measures is a matter for the NSW Government.
Simply Energy	Supports overall the AEMC proposed approach to removing price regulation. Agrees price regulation should be removed all at once for electricity and gas for all consumers in all areas of NSW. Supports ongoing market monitoring using price and non-price indicators to assess the continuing state of competition. Recommends AEMC set guidance around the information requirements from retailers to reduce regulatory burden. Recommends AEMC consider placing a time limit on how long market monitoring should be in force. (p. 1)	Noted. The AEMC sets out its recommendations on market monitoring, and the accompanying reasons, in section 7.5.

Consumer engagement

Stakeholder	Issue/Comment	AEMC response
AGL Energy	Agrees with the Commission's focus on enabling consumers to compare competing energy offers in an informed way. Notes there may be merit in assessing the effectiveness of the mechanisms that have been implemented through NECF to achieve this objective. Considers there is no immediate need for an initiative modelled on the UK's Tariff Information Label considering the availability of the AER's comparator tool *Energy Made Easy*. Considers it would be prudent to permit the arrangements under NECF, and the NSW derogations, to be implemented in full and given an opportunity to be fully utilised. Suggests if, after a period, consumers are not being adequately informed or protected, measures should be put in place to rectify shortcomings. (p. 5)	Noted. The AEMC considers these matters in detail in the supplementary report to be released in October 2013.
Alinta Energy	Disagrees with the AEMC view that additional information/engagement programs be in place prior to removal of price caps. Submits it remains in the best interest of retailers to ensure information presented is clear, transparent and easy to understand. Notes additional measures can be conducted in conjunction with removal of price regulation and continue thereafter. (p. 2)	Noted. The AEMC considers these matters in detail in the supplementary report to be released in October 2013.
Australian Power & Gas	Supports the AEMC efforts to investigate and recommend measures to improve consumer understanding of ability to switch retailers and to provide customers with the right information to help them make informed choices. Agrees customers will benefit most from the removal of price regulation when coupled with measures that help consumers to be confident about their ability to change retailers and select an energy plan that suits their needs. Notes it does not consider consumer engagement issues relate to availability of information; rather, asserts the presentation of such information needs to provide consumers with adequate and relevant information that allows them to choose an appropriate energy plan. Notes consideration needs to be given to how and by whom this information is provided. Suggests retailers, consumer organisations, and government each have a role to play to provide consistent messages and information. (pp. 2-3)	Noted. The recommendations for a consumer engagement plan will be included in the Supplementary Report to be released in October 2013.

Stakeholder	Issue/Comment	AEMC response
Australian Power & Gas	Does not agree with the AEMC draft recommendation that consumer engagement blueprint should be implemented prior to removal of retail price regulation. (pp. 2-3)	The Commission notes any decision to remove price regulation and implement additional consumer engagement measures, and the timing of such measures, is a matter for the NSW government. The recommendations for a consumer engagement plan will be included in the Supplementary Report to be released in October 2013.
CHOICE	Welcomes the AEMC's work to develop a consumer engagement blueprint with stakeholders. Notes the objective should be around consumer confidence to choose the best plan. Submits consumers need the right information and tools to support choice. Notes problems with complexity of tariffs and refers to Victoria ESC margin analysis indicating host retailers have higher margins for standing offers than others. Recommends AEMC: discuss ESC work in consumer areas; conduct research regarding suitability of criteria used on ESC comparison website; and, consider relevant UK reforms. Suggests discussion of potential reforms to provide consumers with nudges and improving the AER comparison website (*energymadeeasy.gov.au*). (pp. 7-11)	Noted. The AEMC considers these matters in detail in the supplementary report to be released in October 2013. Regarding the ESC margin analysis, see section 4.4.5.
EnergyAustralia	Notes there will be consumers who will need additional assistance and supports targeted government information programs for these consumers. Supports the provision of information and engagement programs to enhance consumer understanding of the benefits of increased choice of energy products. Notes EnergyAustralia has ceased selling activities via the door-to-door knocking marketing channel. (pp. 5-6)	As above.
Energy Retailers Association of Australia	Notes introduction of NECF in NSW and considers there is no need to implement additional consumer protections. Supports provision of information and engagement programs to enhance consumer understanding of the benefits of increased choice of energy products. Notes its concern if development of consumer engagement programs slowed the timely removal of price regulation. Notes there may be some consumers or consumer groups requiring additional assistance and supports targeted government information programs for these	Noted. The recommendations for a consumer engagement plan will be included in the Supplementary Report to be released in October 2013.

Stakeholder	Issue/Comment	AEMC response
	consumers. (pp. 2-3)	
Energy Supply Association of Australia	Supports the use of government-backed switching websites to provide consumers with information to assist them in making their choices. Suggests government could provide grants to targeted community and not-for-profit groups who represent consumers and need additional information and support to participate effectively in the market. Does not agree with AEMC that energy "customers require a high degree of understanding and knowledge to participate effectively in the market". Suggests consumers merely need to be able to compare different end products. Considers it is not obvious what information gap exists for the vast majority of customers. (pp. 1-3)	As above.
Energy & Water Ombudsman NSW (EWON)	Supports AEMC suggestion that information and awareness programs begin prior to implementation of a transitional tariff. Recommends such a program provides clear and simple information tailored to consumers who remain on regulated tariffs. (p. 2)	As above.
Energy & Water Ombudsman NSW (EWON)	Notes it raised the issue of obsolete tariffs in its Issues Paper submission and queries where obsolete tariffs fit into the proposed transitional arrangement. Suggests a tailored information program targeting consumers on obsolete tariffs to inform them of the transitional arrangement to minimise price shock. (p. 2)	Noted. The AEMC recommends that the market monitoring discussed in section 7.4 focus on such areas, as discussed in section 5.5.
ERM Power	Agrees some form of information campaign may be useful, such as the approach taken in South Australia. Suggests clarity is required regarding need for additional information; notes it is unclear if there is benefit in providing more information. Notes there is limited evidence-based policy discussion around reasonable expectations for consumer information requirements. Notes treating all consumers alike will not progress issue. (pp. 3-8)	Noted. The recommendations for a consumer engagement plan will be included in the Supplementary Report to be released in October 2013.
Lumo Energy	Supports the Commission in recommending measures to improve consumer engagement and participation in the market. (pp. 1-2)	Noted.
NSW Irrigators'	Agrees with the AEMC recommendation to introduce measures to make it easier for consumers to engage with the market, receive information and compare	Noted. The recommendations for a consumer engagement plan will be included in the

Stakeholder	Issue/Comment	AEMC response
Council	offers. Notes the complexity of the electricity market and the many offers available and considers the diverse costs involved in switching makes it difficult for consumers to compare. (p. 3)	Supplementary Report to be released in October 2013.
Origin Energy	Agrees with the AEMC that increased consumer engagement could improve consumer outcomes and help to sustain public support for full competition. Supports a coordinated information campaign to coincide with the removal of price regulation, involving government, retailers, and community organisations. (pp. 2, 5)	The AEMC considers these matters in detail in the supplementary report to be released in October 2013.
Origin Energy	Supports a coordinated information campaign to coincide with the removal of price regulation, involving government, retailers, and community organisations. (pp. 15-16)	Noted.
PIAC	Recommends any information campaign be lead by the NSW government with input and assistance from retailers and community/consumer organisations and should run and be tested for effectiveness prior to removal of price regulation. Recommends retailers be required to provide a tariff information label, including a comparison tariff rate to complement Energy Price Fact Sheets. (pp. 12-14)	Noted. The recommendations for a consumer engagement plan will be included in the Supplementary Report to be released in October 2013.
Simply Energy	Supports AEMC comments on providing information that helps consumers understand their choices. Suggests taking into account NECF information provision requirements when assessing the need for additional information. (p. 2)	Noted. The recommendations for a consumer engagement plan will be included in the Supplementary Report to be released in October 2013.

Other

Stakeholder	Issue/Comment	AEMC response
AGL Energy	Agrees with the Commission's draft conclusion that price regulation has been a factor in explaining the current lack of widespread availability of time-of-use products. Agrees with AEMC that the removal of price regulation will likely encourage greater flexibility in retail product offerings and tariff structures. Agrees that information about time-of-use pricing would be a useful part of the consumer engagement program the Commission is developing. (pp. 1-2)	Noted.
AGL Energy	Considers it unnecessary for the Commission to seek to strengthen policies around the regulation of contract terms given their prominence and consideration in the development of the NECF. (p. 4)	Noted. The AEMC has recommended a continuation of existing consumer protections, as discussed in section 7.6.
EnergyAustralia	Supports the Commission's assessment framework. (p. 3)	Noted.
Momentum Energy	Notes protections for small consumers in NSW have been extended and improved with the introduction of the NECF. (p. 2)	Noted.

Abbreviations

ACCC	Australian Competition and Consumer Commission
ACT	Australian Capital Territory
AEMA	Australian Energy Market Agreement
AEMC or Commission	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
AP&G	Australian Power & Gas
Commission	See AEMC
ERAA	Energy Retailers Association of Australia
ESAA	Electricity Supply Association of Australia
ESC	Essential Services Commission
ESCOSA	Essential Services Commission of South Australia
ETEF	Electricity Tariff and Equalisation Fund
EWON	Electricity and Water Ombudsman of NSW
EWOV	Energy and Water Ombudsman of Victoria
GJ	gigajoules
HHI	Herfindahl–Hirschman Index
IPART	Independent Pricing and Regulatory Tribunal
IT	information technology
Jemena	Jemena Gas Networks
kWh	kilowatt hours
LNG	liquefied natural gas
LPG	liquid petroleum gas

MCE	Ministerial Council on Energy
MJ	megajoules
MWh	Megawatt hours
NECF	National Energy Customer Framework
NEM	National Electricity Market
NERL	National Electricity Retail Law
NERR	National Electricity Retail Rules
NSW	New South Wales
PIAC	Public Interest Advocacy Centre
PJ	petajoules
Sapere	Sapere Research Group
SCER	Standing Council on Energy and Resources
SCO	Standing Committee of Officials
STTM	short term trading market
TJ	terajoule
TOU	time of use