



**Australian Energy Market Commission
Review into the Effectiveness of
Competition in the Electricity Retail Market – ACT**

Retailer Research Report

Prepared for the AEMC

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Contents

- 1. Executive Summary 3**
- 2. Background..... 8**
- 3. Context and Objectives 9**
- 4. Research Methodology.....10**
- 5. Research Findings.....13**
 - 5.1 Knowledge and Perceptions of the ACT Electricity Market13
 - 5.2 Retailer Offers and Marketing Activities.....16
 - 5.3 Competitiveness, Retailer Rivalry and Customer Switching.....24
 - 5.4 Catalysts and Barriers to Market Entry, Expansion or Exit.....33
 - 5.5 Future Directions.....43

Appendix 1 – In-Depth Interview Guide

GA Research is accredited to ISO 20252 and is a member of the Association of Market and Social Research Organisations (AMSRO) and as such is bound by the Market and Social Research Privacy Principles (M&SRPPs).

Note to the Reader

In preparing this report we have presented and interpreted information that we believe to be relevant for completing the agreed task in a professional manner. It is important to understand that while we have sought to ensure the accuracy of all the information incorporated into this report, information has been gathered through in-depth qualitative interviews and as such is not statistical or representative of the views of all licensed electricity retailers in the ACT, and in some cases retailer perceptions may not accurately reflect facts.

This project was conducted in compliance with ISO 20252 guidelines.

1. Executive Summary

Background

The Australian Energy Market Commission (AEMC) is undertaking a review of the effectiveness of competition in the Australian Capital Territory (ACT) electricity retail market for small customers; those using less than 160MWh of electricity a year. The review has a range of components including independent market research with consumers and retailers.

As part of its review, the AEMC commissioned GA Research to conduct qualitative market research with electricity retailers licensed to operate in the ACT. In all there are 19 licensed electricity retailers in the ACT, of which four are referred to within this report as “active” in the small customer market because they have existing customers, while “inactive” retailers are those that do not currently have any customers.

The ACT small customer retail electricity market comprises approximately 120,000 households and 10,000 small businesses¹. Full Retail Contestability (FRC) was introduced in the ACT in 2003. Prior to the introduction of FRC, 99% of retail electricity consumers were customers of the incumbent supplier, ActewAGL Retail, which they had no choice about. Following the introduction of FRC all small customers continue to have access to a regulated retail price but may opt for a negotiated price. ActewAGL Retail remains the predominant electricity retailer in the ACT².

The research was perception based and involved ten in-depth interviews with one or more senior representatives from each of the retailers that participated.

The interviews followed a structured line of enquiry focusing upon the extent to which retailers compete for customers and the basis upon which they compete; marketing strategies utilised by retailers; customer switching behaviours, drivers and barriers to market entry, expansion or exit; product and service innovation; the role of dual fuel and green energy products; and the future

¹ According to the Australian Bureau of Statistics, Census 2006 data for the ACT, and the 2007 Count of Businesses with less than 20 employees, *Counts of Australian Businesses, including Entries and Exits, Jun 2003 to Jun 2007*, release 8165.0, released at 11:30 am (Canberra time) 21 December 2007.

² Information source: AEMC 2010, *Review of the Effectiveness of Competition in the Electricity Market in the Australian Capital Territory*, Issues Paper, 4 March 2010, Sydney, p8.

outlook. Underpinning this investigation was an assessment of the internal and external factors inhibiting greater market participation from a retailer perspective.

Key Findings

While it is relatively small, the electricity retailers interviewed report that they see the ACT as an attractive market for small consumers. Despite its smaller size than other jurisdictions, the retailers interviewed do not really regard this as a major issue; they see the market as sufficiently large to pursue, generally more affluent than other jurisdictions, and as having attractive levels of electricity use, particularly during the winter peak.

The representatives of the ten retailers interviewed say that they became licensed in the ACT primarily because they recognise this attractiveness but also for some, to a lesser degree, because it gives them national coverage. Most of the retailers interviewed that are currently inactive (yet to commercially enter this market) stated that they would definitely become active in the market if the right regulatory conditions were in place.

Currently, most of the retailers interviewed think that a relatively low level of competition exists in the ACT retail electricity market for small customers – most commonly rating it at around a 3, 4 or 5 out of 10, although ranging from a couple of zeros to an “8 or 9”.

The six retailers who rated the competitiveness of the market as 5 or below indicated that the predominant reason for this view is that the regulated price is too low to enable the commercial margins that would attract new entrants into the market. Some participants who gave a higher rating also agreed that a higher regulated price, or the removal of price regulation, would result in more effective competition.

A couple of participants pointed out that three of the four active electricity retailers in the ACT small consumer market are part or fully government owned, which they think creates some distortion in the market because government owned retailers are less concerned with profit than privately owned ones.

According to most of the retailers interviewed, the barriers to entry have been exacerbated by high and volatile wholesale prices over the last few years, with a couple pointing out that this started in 2006 or 2007.

Only one active retailer indicated that they are marketing to attract new customers at present. In contrast, most of the remaining licensed retailers interviewed which currently have no customers say they will not seek to market to new customers until the regulated price is increased substantially or removed.

The three other active retailers describe themselves as being in a passive holding pattern when it comes to marketing, as they are not able to offer customers a better deal than the standing price. One of these retailers stated that when a customer's contract term ends, they are advising the customer to return to ActewAGL Retail (their original allocated retailer).

A range of other factors are contributing to the low level of perceived competitiveness in the market, according to the retailers interviewed. These featured much less prominently in the discussions, and include (in broad descending order of mentions):

- The dominance of the incumbent, ActewAGL Retail, as well as its bundling power across all utilities. Note that retailers respect the way that this retailer has commercially managed this market;
- Additional compliance and administrative costs in the ACT; seen as barriers to entering the market, due to the ACT having its own jurisdictional regulations;
- The relatively small size of the market compared to other parts of the national electricity market;
- The requirement to administer the feed-in tariff in terms of the associated costs;
- The prudential requirements of ActewAGL, where one small retailer described the bank guarantee as being more than ten times the amount of the next most costly jurisdiction;
- Inflexibility in how ActewAGL negotiates the network user system agreements; and
- Mentioned by one retailer, the requirement to offer a green energy product.

Most retailers that participated in this research, including the inactive retailers and ActewAGL Retail, wish to see the removal of price regulation. Most of the inactive licensed retailers have indicated that the removal of retail electricity price regulation would be the trigger they need to commence their pursuit of customers within the market. They feel that delaying this will not only delay the facilitation of more effective competition, but would also lead to a greater price shock for consumers in the future, due the rising levels of wholesale costs that will eventually need to be passed on.

Most of the retailers interviewed drew attention to the fact that Victoria has removed price regulation and implemented a price monitoring model, and that Victoria is in turn the most competitive retail electricity market in the world. They frequently upheld Victoria as the exemplar for the ACT Regulator and Energy Minister to consider. These retailers were essentially asking the regulator to have faith that the market will regulate itself.

The few retailers interviewed who don't necessarily think price regulation needs to be removed, do at least think that the regulated price needs to be increased substantially; to a level that is sufficient to allow retailers to achieve commercial margins (in the face of high, volatile wholesale prices in particular) and thus justify their entry into the market. Some suggested the regulated price would need to rise by as much as 30-40% to stimulate the same level of effective competition as removing price regulation would. As a result, these participants suggested that it would be more efficient to skip this step and proceed directly to removing price regulation.

Either way, there is an expectation among all retailers interviewed that retail prices will need to rise so that they are more cost reflective. While there may be some short term pain for consumers in this, many of the retailers interviewed pointed out that the ACT Government has a responsibility to help protect those most vulnerable to any price shocks. In addition, a couple of participants expected that the higher incomes of consumers in the ACT would help with the market's ability to absorb any such shocks.

If price regulation is not removed, a few of the retailers interviewed indicated that a staggered increase in pricing, beginning immediately, would help protect the market from the shock that would be produced by a single step approach to more cost-reflective pricing in the future.

Longer term, the National Energy Customer Framework is expected by most of the retailers interviewed to provide an added incentive to retailers to actively compete within the ACT (and other jurisdictions). This is because cost savings will be realised through reduced regulatory compliance and administration costs, which will help to improve their margins.

Many of those interviewed also expect future initiatives such as smart meters and a potential carbon price to prompt customers to become more aware of their energy use and consider their cost saving options. They expect this to further boost the extent to which customers shop around for a better deal. As such, some retailers think this will prompt retailers to lift their marketing efforts to customers and sharpen their competitive focus.

Conclusions

From the perspective of most of the retailers interviewed, the ACT electricity market for small customers currently has a low level of effective competition.

In their opinion, the predominant reason for this is continued price regulation at a low rate that does not reflect the true costs or provide the necessary commercial margins for either inactive retailers to justify entering the market or for the smaller active players (i.e. those with customers) to ramp up their efforts and recommence active marketing activities.

However, the comments from the retailers interviewed indicate that the dominant retailer, ActewAGL Retail, is aggressively competing to retain its existing customers and acquire new customers, and that it does this because it feels the constant threat of the other retailers, both active and inactive.

If retail price regulation is removed, the retailers that were interviewed indicate that there will be much greater competitive activity within the ACT market, and that they are likely to respond relatively quickly to such a change.

Longer term, most of the retailers interviewed think that other initiatives such as the National Energy Customer Framework will provide added incentives for retailers to compete more actively within the ACT.

Most of the retailers think that keeping the regulated price as low as it is now could potentially be seen as beneficial for ACT residents and small businesses 'in the short term'. In the longer term they consider that there is a risk of a larger price shock when the time does come for the retail price to become cost reflective. Many of those interviewed think that removing the regulated price will be likely to lead to short term price hikes but that it is in the ACT Government's longer term interest in terms of creating a more competitive market and better consumer choice.

2. Background

The AEMC and Electricity Market Competition Reviews

The Australian Energy Market Commission (AEMC) was established in July 2005 and is charged with setting the Rules for the national energy markets. It also provides policy advice to the Ministerial Council on Energy (MCE) on energy market development in relation to the national electricity market (NEM) and elements of the natural gas markets.

As part of its advisory role, the AEMC is required to conduct a review of the effectiveness of competition in the electricity and gas retail markets in each NEM jurisdiction (retail competition reviews). The AEMC began its retail competition review of energy markets in Victoria in 2007 followed by South Australia in 2008. In both cases the retail competition in these markets was found to be effective. The AEMC recommended that price regulation could be phased out.

The review for the Australian Capital Territory (ACT) is being carried out in 2010, focusing on electricity only as there is no retail price regulation for gas, specifically the electricity retail market for small customers, which is residential and small business premises using less than 160MWh of electricity a year.

The AEMC invited GA Research to conduct research with the ACT's electricity retailers to complement the research with consumers and more fully inform the review.

GA Research

GA Research is a market and social research company that specialises in exploring, understanding, measuring and monitoring stakeholder perceptions, as well as knowledge, experiences, needs and wants, drivers and barriers, behaviours and intentions.

GA Research is a member of the Associations of Market and Social Research Organisations (AMSRO) and is quality accredited to the ISO 20252 standard for market and social research. All GA Research employees are members of the Australian Market & Social Research Society and are bound to observe its Code of Professional Behaviour and associated Privacy Principles, which covers both the ethics and standard conditions of conducting and reporting marketing research. The Code defines market and social researchers' responsibilities to their respondents, to their clients and to the community at large.

3. Context and Objectives

The unique nature of the ACT electricity retail market has guided our methodological approach as well as what we consider the key research objectives of the project.

The ACT small customer retail electricity market comprises approximately 120,000 households and 10,000 small businesses. FRC was introduced in the ACT in 2003. Prior to the introduction of FRC, 99% of retail electricity consumers were customers of the incumbent supplier, ActewAGL Retail, which they had no choice about. Following the introduction of FRC all small customers continue to have access to a regulated retail price but may opt for a negotiated price. ActewAGL Retail remains the predominant electricity retailer in the ACT.³

There are currently 19 registered electricity retailers in the ACT, although only four of these are active participants in the market, in the sense that they currently have small electricity customers (although they may not necessarily be seeking to acquire new customers). Our preliminary desk research and briefings indicated that ActewAGL Retail is the dominant retailer with most of the market share and that, anecdotally, residents in the ACT are not very familiar with other energy suppliers. The table below lists the active and inactive licensees in the ACT market, based on data collected from the Independent Competition and Regulatory Commission (ICRC) website⁴.

Currently active in the ACT small customer market:	<ul style="list-style-type: none"> • ActewAGL Retail • TRUenergy Pty Ltd • Country Energy • EnergyAustralia
Registered licensees currently inactive in the ACT small customer market:	<ul style="list-style-type: none"> • AGL Sales Pty Ltd • AGL Sales (Queensland Electricity) Pty Ltd • Aurora Energy • Australian Power and Gas Pty Ltd • Dodo Power and Gas Pty Ltd • ERM Power Retail Pty Ltd • Integral Energy Australia • Jackgreen (International) Pty Ltd • Momentum Energy Pty Ltd • Origin Energy Electricity Ltd • Powerdirect • Red Energy • Sanctuary Energy Pty Ltd • SUN Retail • TRUenergy Yallourn Pty Ltd

³ Information source: AEMC 2010, *Review of the Effectiveness of Competition in the Electricity Market in the Australian Capital Territory*, Issues Paper, 4 March 2010, Sydney, p8.

⁴ http://www.icrc.act.gov.au/utilitieslicensing/current_licensees

Research Objectives

The key objectives of the research were to:

1. Understand the extent to which retailers compete for customers, the basis upon which retailers compete and the marketing strategies employed;
2. Explore retailers' perceptions of small customers' propensity to switch retailer; the drivers behind the urge to switch and the actual tipping points that lead to switching;
3. Assess retailer perceptions of the catalysts and barriers to market entry, expansion or exit, including:
 - a. Market structure and conditions
 - b. Regulatory framework
 - c. Internal corporate factors such as resources, capacity and strategy
 - d. Product based factors, including tariff and product innovation and flexibility as well as the importance of dual fuel and green energy products; and
4. Understand retailers' attitudes towards competition in the ACT market and their thoughts on what they would like to see happen in the future, including who should be responsible for driving any changes.

In the context of the ACT electricity market, with a large number of retailers not yet actively involved, much of the research focused on objectives 3 and 4; in other words, exploring the internal and external factors inhibiting greater market participation.

4. Research Methodology

The AEMC commissioned GA Research to specifically conduct qualitative market research with electricity retailers licensed to operate in the ACT, focusing on competition for small customers. In-depth, qualitative interviews were the methodology used for the research.

The Sample

In all, at the time of the research, there were 19 licensed electricity retailers in the ACT according to the ACT Independent Competition and Regulation Commission's website.⁵ The AEMC provided GA Research a target list of 13 of the licensed retailers, as the AEMC

⁵ http://www.icrc.act.gov.au/utilitieslicensing/current_licensees

determined that the other six were not in scope for the research for various reasons – for example, one had gone into voluntary administration, while another was not licensed for small customers.

Four of the 13 retailers were identified by the AEMC as active in the ACT small customer market, in the sense that they have an existing customer base of small customers (i.e. residential and small business customers that use less than 160MWh of electricity per year) – and not necessarily in the sense that they are currently marketing to acquire new customers. Indeed, this is something that was explored in the interviews. Please note that this definition has been retained throughout the report, with “inactive” retailers referred to as those that are licensed in the ACT but do not have small electricity customers there, and “active” customers are those that have an existing small customer base.

Representatives from the 13 retailers were identified and invited to participate in the research, typically with at least two representatives from each retailer invited. The final sample of interviews consisted of 19 representatives across ten retail electricity companies, with one having declined and two not being available. The retailers represented in the research are:

Currently active in the ACT small customer market:	<ul style="list-style-type: none"> ActewAGL Retail TRUenergy Pty Ltd Country Energy EnergyAustralia
Registered licensees currently inactive in the ACT small customer market:	<ul style="list-style-type: none"> AGL Sales Pty Ltd Australian Power and Gas Pty Ltd Dodo Power and Gas Pty Ltd Momentum Energy Pty Ltd Origin Energy Electricity Ltd Sanctuary Energy Pty Ltd

Some of the questions posed in the interviews required the participants’ understanding of a range of topics and tapped into specialist knowledge regarding regulatory frameworks, marketing activities and consumer insights. For this reason, it was often necessary to interview more than one representative from the company. Participants included CEOs, retail and operational managers, personnel responsible for marketing, corporate affairs, regulatory affairs and government relations.

The Process

Following appointment, AEMC briefed GA Research in more detail and identified a target list of whom to invite to participate in the research. GA Research prepared a detailed question line for the in-depth interviews for AEMC’s approval.

AEMC then sent a letter to the CEO of the nominated target organisations explaining that GA Research was appointed to conduct the retail competition review with retailers on behalf of

AEMC and invited them and/or other relevant personnel to participate. The letter provided the opportunity to opt out if they wished, with GA Research to be in touch to schedule a time to meet in the following two to three weeks. GA Research contacted the identified targets and scheduled the in-depth interviews.

In April and May 2010, GA Research conducted the ten interviews with representatives from those retailers who accepted the invitation. There were between one and four participants in each interview. They ranged from one to two hours in duration and followed a semi-structured discussion guide with questions that were largely open-ended, to ensure key objectives were addressed (see Appendix 1).

Senior GA Research staff conducted all of the interviews. Nine were conducted face-to-face in Canberra, Sydney or Melbourne, and one was via telephone, as the representatives were based in another location. The question line and emphasis of the interviews was changed depending on type and size of company, exposure to the ACT market, and whether the retailers are active or inactive in the ACT retail electricity market.

Following completion of the interviews, GA Research undertook detailed analysis of its own notes and the interview transcripts against the research objectives. The findings of this analysis follow.

Quality Assurance

All interviews were conducted in accordance with market industry requirements, on the basis of the participant's comments being kept unattributable within this report. Confidential transcripts of each interview have been provided to the AEMC, with the participants' permission. Participants in some of the interviews requested a slightly edited transcript be submitted to the AEMC, with particularly confidential comments to be omitted.

The three GA Research interviewers on this project are all Qualified Practising Market Researchers (QPMR). QPMR is the peak professional benchmark for market and social researchers to ensure that researchers operate in a way that is highly professional and quality driven. Gaining QPMR accreditation means that the researcher has demonstrated a commitment to continuous professional development which raises the professional standards of market and social research.

5. Research Findings

The findings of the research are set out in the following chapters:

- Knowledge and Perceptions of the ACT Electricity Market
- Retailer Offers and Marketing Activities
- Competitiveness, Retailer Rivalry and Customer Switching
- Catalysts and Barriers to Market Entry, Expansion or Exit
- Future Directions

Verbatim participant quotes are provided throughout the report to illustrate findings, with light editing where necessary to maintain participant confidentiality. Relevant conclusions are provided at the end of each section.

5.1 Knowledge and Perceptions of the ACT Electricity Market

One of the considerations in terms of evaluating the effectiveness of competition in the retail electricity market is to consider the extent to which retailers are knowledgeable and engaged with the market. Thus participants were asked about their knowledge and perceptions of both customers and retailers in the ACT retail electricity market for small consumers.

Small Electricity Consumers

The most prominent feature of the ACT market according to all of the retailers interviewed is that it is small in comparison with other markets, both in terms of consumer numbers (generally understood by most of the retailers interviewed to be around 130,000 small customers across households and small businesses) and, as mentioned by a few participants, its geographical compactness. While many inactive retailers commented that the number of consumers makes the market less attractive than other markets, they hastened to add that they still see the ACT as an attractive market that they would definitely like to pursue, when the conditions are right, even if they do choose to pursue other markets first.

“Certainly at the moment, the ACT would be probably one of the last places we’d get into. There’s no firm plans about what happens after Victoria at this stage. It sort of, it depends on where we’re able to get access to and how easy it is for us to find customers in the various states. And really what sort of prices we can offer to our customers in those states. As I said, there’s the high compliance costs for entering into ACT and NSW, you know, sort of say to me, at this point in time, we might, we’d probably go NSW first, ’cause they’re a larger customer base, and then off the back of that do ACT

because they've got similar, similar functions. I think also, you know, ActewAGL's position inside ACT also makes it a bit harder to crack into. But at the same time, we're also, we've probably got a better advantage compared to some of the other retailers in that we also offer telephony type stuff and ActewAGL also offers it. You know, rather than some other you know, gas only or electricity only type retailers.” (Inactive)

However, one active retailer that is currently in a holding pattern in terms of marketing has a view that the market is not particularly attractive because of its comparatively small size, based on their experience of having moved through the market with door to door marketing quite quickly:

“... in Victoria we then had a clean canvas to go and say, 'Where do you go and really drive hard?'. So Victoria was our market of opportunity to participate. That's where we've been spending, over the last two years, is spent most of our effort in building up a business down there, or, you know, re-entering the market down there. So I think it's very much one of the, the size of the prize in terms of the opportunity. Even if you went gang busters [in the ACT] and got 30% of the market, you're still talking about quite a small number of customers.” (Active)

Most participants stated that small electricity customers in the ACT share a lot of similarities with those in other jurisdictions. One inactive retailer stated:

“I don't think there's too many unique aspects about the ACT market that's different to the Victorian market.” (Inactive)

However, a few common notable (perceived or actual) differences were outlined by many of the retailers interviewed:

- There are significant peaks in demand during winter, and to a lesser extent in summer (most commented on this);
- Incomes are thought to be much higher on average (most commented on this);
- A couple commented on the average consumers in the market having an above average level of education; and
- There is thought to be a higher degree of transience in the population, particularly among politicians and federal government personnel, of which there are a proportionately high number in the ACT.

Small businesses in the ACT are not regarded by the retailers interviewed as inherently different from small businesses in other jurisdictions.

About half of the participants described the ACT market as being very similar to the regional New South Wales market from their perspective – especially those that also service regional New South Wales.

“To some extent the ACT is nothing but a large regional centre in New South Wales. There’s no great differentiators between the New South Wales market and the ACT market.” (Active)

A couple of retailers added that because of the current market situation, customers in the ACT are likely to require less education on a couple of fronts: firstly, that they do have the choice to switch retailers – which they say is evidenced by around 20% of the market being on market contracts, and secondly that services can be bundled – a concept they think many will be familiar with given this is a key component of the incumbent’s offer.

“We’re aware that something like 20% of customers in the ACT are on market contract, so they do have a tendency to take up market contracts and look for offers that are going to provide them a benefit, which then just works in with our strategy and going in knowing that there is awareness there. So there’s not a need to make customers aware of how the market works so much, they’re switched on to it so to speak, which again makes it attractive from an acquisition perspective, that you don’t have to educate the customer as much about what the market is and what it does.” (Inactive)

“ActewAGL’s probably a little bit more like us ... in that they do have ... bundling. So in some respects they’re a bit more of a direct competitor, but then again it’s a bit, you know at the same time, that makes the market a little bit more fertile for us, I think, because it’s not a completely foreign concept.” (Inactive)

While many of the retailers interviewed have conducted some market research in the ACT in the past, only one of the retailers interviewed said that they are regularly conducting market research there. For other retailers, they are not conducting market research largely because changes are not thought to have occurred within the market to warrant closer inspection. Many of them spoke of making periodic assessments as to whether they would enter the market, with some doing this more frequently than others, but generally not more than once every 6 to 12 months.

Retailers

The ACT electricity market for small customers is seen to be very much dominated by ActewAGL Retail, according to the ten retailers represented in this research. To a large extent this is evident to other retailers because of the amount of above the line marketing that they have seen, as well as publicly available information and word of mouth in the industry.

In terms of market share, most of the other retailers interviewed think that ActewAGL Retail possibly has around 70-80% of the customers, and that the rest is shared among the others, but this is not something that they have definite knowledge of.

Among those interviewed, other retailers most commonly thought to be active were Country Energy, EnergyAustralia, TRUenergy, Integral Energy and Origin Energy.

"I would say 80% ActewAGL, I'd say probably 10% Energy Australia, probably 5% Country Energy, and maybe two or three percent Origin, one percent TRU. Something like that, I don't know." (Inactive)

It is worth noting that some of the inactive retailers stated that they do have some presence in the market via a small number of renewable energy customers and/or larger commercial and industrial customers that are part of a multi-jurisdictional contract; the latter are referred to as 'tails'.

Conclusions

Many of the retailers interviewed feel that they have a good level of knowledge about the ACT market, although this does vary depending on how active they are in the market and, for inactive retailers, how recently they have reviewed their decision about whether to become active there.

5.2 Retailer Offers and Marketing Activities

To help understand competition within the small customer retail electricity market in the ACT, active retailers were asked about their market offers, marketing activities and marketing strategies. Awareness of these activities was explored with inactive retailers.

Retailer Offers

The active retailers interviewed are offering a number of different products and services, summarised below:

- ActewAGL Retail offers discounts on bundled services, with bundling across a number of different services including electricity, gas, green energy, internet, broadband, pay TV and mobile phones;
- All active retailers offer both electricity and gas;
- All active retailers are required to (and do) offer green electricity products to customers, and a solar feed-in tariff; and
- In addition, TRUenergy offers a number of packages with discounts off the bill for dual fuel and in recognition of desired behaviours such as paying by the due date.

All of the retailers interviewed are aware that ActewAGL Retail offers service bundling, covering a range of services including electricity, gas, internet connections, mobile phones, pay TV, and

that it is also the ACT's only water and sewerage service provider. This ability to bundle is seen by the retailers interviewed as a distinct advantage over other retailers in terms of creating a convenient situation for the customer, building loyalty, and presenting a disincentive to switch to another electricity retailer. There is, notably, general respect towards ActewAGL Retail among other retailers interviewed, and a few retailers expressed a sense of admiration of its successes with bundling and see this as difficult to compete with – although not impossible.

“Well we’re not making a lot of proactive offers yet at the moment. It’s just maintaining our existing customers. Very challenging for us where we have a product with gas and electricity. Having a compelling offer where you’ve got someone that has a full product range of, you know five or six products. So the cards are on the table. It’s very hard for us to differentiate and be aggressive in that space... They do what they say ... the focus on their customers in doing what they said they’d do and following through, and ensuring that their customers had a great experience; they’re really top notch ... so there’s not many businesses that would be able to go, ‘Oh yeah but we do it better here, here and here’. So I don’t think this is a case that they were gifted anything, I think they’ve worked really hard to build something in a, in a parochial market that, that looks at that and goes, ‘Tick, yeah she’ll do me. Happy days’. ... It seems it’s just a market that’s gone into, it’s found an equilibrium there and it’s, it’s not the case of we’ve never experienced anything and felt that there was a, an overhand or a threat from ActewAGL about coming in and making offers that we just said, ‘It kills us, we can’t do anything about that’... I’ve never seen, I would just say, of probably in the national market, they were one of the most admirable organisations. So notwithstanding they’ve got an exceptionally strong position, everything we look at is saying, ‘Yeah they got dealt some cards which could have had them here’, they chose to improve that position over time, in a fashion that was just, you know, didn’t shut anyone out. But of course you know, the more appealing their product range became, the harder it was to make a viable offer. And I don’t get disenchanted people saying, you know, ‘We’re really [annoyed] with ActewAGL, we want to come to you’. A lot of other sectors we do get quite a lot of noise and traffic from people that are just [annoyed] with the incumbent... They chose to embrace a business model that’s very appealing. I quite admire their business model... I mean the ACT’s had a great allegiance to ActewAGL, it’s like a family relationship.” (Active)

“Like, it wasn't as though we're after 50% market share. We just wanted customers who wanted to be with us and, you know, if you're only talking about a few hundred as being sort of a viable base, I don't see the incumbency's in it, you know, necessarily an issue... To make, to differentiate [ourselves] from the ActewAGL-centric view. So I didn't see that particularly for us as being an issue... We were also aware in terms of our competitor monitoring that [about two years ago] ActewAGL were phoning customers that were on contract looking to secure, looking to make them an offer to move back. So they were actually deliberately marketing to customers that we'd acquired. Now, again I didn't think it was necessarily inappropriate, but it sort of shows again their efforts to preserve their market share and to really sort of resist losses as we've done.” (Active)

One participant commented on ActewAGL Retail having water in its product mix, and wondered whether there might be ways to allow other retailers to offer water, as is possible in the UK.

“I think one of the things that is unique about the ACT market is the TransACT component, with the telephones and the water that’s linked in, so it’s much more of a bundled service, which certainly makes those customers potentially harder to move because ActewAGL bundle a lot more than any other retailer. And it’s one of the few markets that we’ve done any research on in the world where sort of bundling of Telco with energy actually works. And we don’t have the ability to bundle water. Obviously I think water would be able to bundle as it does in the UK pretty easily, but certainly they’ve become a lot more tied in, so it would be looking at market structure that might be potentially the ability for other retailers to offer water and other things like that, I’m not sure whether you can or not. So it’s a bit of a competitive advantage for the incumbent around that.” (Inactive)

The inactive retailers interviewed are also aware of the need to come up with differentiated products if they are to successfully enter the market. Those that are looking to enter the market at some stage generally believe that they either currently have such products or will be able to develop them when they do choose to enter the market. Although they tended not to go into much detail for obvious reasons, examples ranged from new bundling offers, to new renewable energy products, tailored products for certain customer segments (e.g. either residential or small businesses), creating new incentives and discount schemes, through to offering different approaches to billing.

Marketing Activities and Strategies

Retailers were asked about their marketing activities and strategies in the ACT. Some clearly did not wish to disclose the details of these for commercial reasons, although enough information was offered to provide a sense of the situation.

Active retailers stated that they are generally keen to hold on to their customers, although they are struggling to match ActewAGL Retail’s price. This dominant player is certainly regarded by the retailers interviewed to have a very active marketing approach to customer retention, suggesting that it genuinely feels the threat of the other licensed retailers in the market. Indeed, the consensus among many of the retailers interviewed is that the most prominent electricity marketing activities in the ACT are being undertaken by ActewAGL Retail. This covers advertising on TV, radio, billboards and bus shelters, direct mail, as well as significant community and sports sponsorships, and education programs.

“Driving around Canberra you see one billboard devoted to energy, and that’s ActewAGL’s sign on their building.” (Active)

“ActewAGL do a lot of things with the community down there and I think that gets them a lot of favours against the football teams or the different events that are around the city. They’ve got a lot more presence.” (Active)

Other active retailers generally describe themselves as being in a passive holding pattern when it comes to marketing, waiting for the regulated price to be lifted to allow for better margins and thus enabling marketing spend. Indeed, one retailer is advising customers when their contract term ends to switch back to their original designated provider, ActewAGL Retail, as they cannot make them a better offer.

“...we’re not wedded to any one market as being a preference. We look at where we can get a good supply site, and where the return’s great.” (Active)

The other active retailers (apart from ActewAGL Retail) also described having been more active in their marketing activities in the early days of FRC, prior to the wholesale price shocks of 2006/2007 which impacted on their ability to justify marketing spend. Their previous activities largely involved door to door and direct mail campaigns drawing attention to the fact that customers can choose their retailer, as well as discounts off the standing price. A couple of the retailers also described a campaign that ActewAGL Retail ran in 2004 telling customers to be cautious about door to door sales people.

“They call it the transitional franchise tariff down there in the ACT. And, and the offers that we’ve had in that market have offered a discount off that rate... So I think all of us that we have web pages and if someone made a call you’d, you’d do something but you wouldn’t intentionally go out to try and target them. It’s just care and maintenance...It’s investing in the customer base that we’ve got. Just a very, very passive relationship. So there is no proactivity in trying to ... that if, if we suffer churn out of that for the fact that what we would have to do to try and reinforce that, that customer relationship, it’s very passive. By the way when we say, this strategy, you’re also, if I talk about the fact that ranking parochialism in markets; I mean the ACT’s had a great allegiance to, to ActewAGL it’s, it’s like a family relationship ... So they are very, very strong in terms of getting this brand allegiance. So to make a compelling offer was challenging ... In the early days ... we went hard. At the moment we don’t have a definitive marketing strategy because we think the degree of difficulty in being successful there is probably the most challenging in terms of the markets we operate in ... the most challenging is South Australia and we choose not to operate in there. Probably then the ACT, then we’d go into ... Queensland and Victoria. We’ve found they’re much better bang for our buck at the moment in our activities.” (Active)

“We never marketed particularly aggressively in the ACT because of, you know, the historical lack of margin, but we did want to be able to have a product offering for someone who was attracted to us... We’ve tended to try and resist just offering a discount off [the regulated price], something else that might, you know, differentiate us, but you still have to be able to say generally to the customer that you’re going to see a

saving... We did some doorknocking I think at one stage but not for a very long period...In recent times customers that are coming off contract we're advising them to go back to the standing tariff ... back to ActewAGL. We are one of the retailers that said to the ICRC that we are now advising customers that come off contract that we can't make an offer that is better than the standing offer that they'd had." (Active)

"You can click on our website and find the price for the ACT, which is entirely passive. And you could arrange a connection through a real estate agent using someone like Connect Now, or you could go direct to [their] website yourself, and you will find [retailer] promoted there, but that's it." (Active)

One of the retailers described their "low cost" customer retention strategy as being no different to their strategy in other jurisdictions. This was described as largely a case of using direct mail. The retailer has found that this works.

"The customer retention program in the ACT is the same as it is universally. So where we are writing to customers either with some form of rewards campaign, or the X campaign or whatever, or even just thank you, then the ACT customers aren't specifically excluded from that. But we tend to lean towards lower cost retention campaigns, mostly in the form of direct mail, and often in the form of offers the customer can take up if they choose to. ... Look the reason for that is because it works. Most customers have an expectation of their utility, that they're there when they need to talk to them, and that's probably the big bit. So you build customer satisfaction by things like sending out letters or newsletters and that sort of stuff, but you build customer loyalty through their contact with you. ... I'm not saying we're exceptional at that compared to our competitors, but the fact that in terms of our retention strategy, we at least acknowledge how important that part of it is, as opposed to sending people gifts when they really all they wanted was for us to answer the bloody phone when they rang." (Active)

For inactive retailers, should market conditions improve, many claimed that they would then seek to enter the market by employing door to door sales teams, with either periodic or continued presence in the market. Others indicated that they would use telesales and/or direct mail.

"We go to towns in country Victoria that have two or 3,000 people in it, but we just treat it like I said as a different thing. We just go there for a week, or something like that, once every six months, and we do it on a campaign basis. So you'd probably treat the ACT like an extended campaign. In Victoria we sign customers up all over the whole state, virtually in every town." (Inactive)

One of the retailers with existing customers commented that the inactive retailers are only licensed so that they can provide a national service to customers that they also service in other states. A few of the inactive retailers acknowledged their need/desire to provide a national

service, but all but one said they do intend to start actively marketing in the ACT when the regulatory conditions are right.

“They are licensed. You know, around the fact that they might have had the opportunity to get Parliament House or some of these other key, key sites which was the game we were playing ten years ago, but that’s all changed now. You realise you can’t build a jurisdictional business on the back of one business... I don’t think any of those other businesses down there are offering anything in any substantive order. There might be some, often they’ve got one or two customers because they’ve picked up someone in Melbourne who’s got, also got bases in the ACT, but that’s probably where most of that business is derived.” (Active)

A Decline in Negotiated Contracts?

Participants were asked if they were aware of the number of customers on a negotiated market contract. Only a couple were aware of the most recent publicly available figures, which indicate that despite growing to around 34,000 by mid-2007, the number of negotiated market contracts had fallen to approximately 30,000 as of mid-2008⁶. This data suggests that a number of customers had returned to the regulated retail price.

In turn retailers were asked why they thought this had occurred. A number of hypotheses were offered. The most common was that the regulated price is lower than the negotiated price – or in other words – that retailers are unable to offer a market contract that is below the regulated price because there is insufficient margin after the wholesale, distribution and other costs. A few participants added that unlike other jurisdictions, customer acquisition costs are not factored into the ACT’s regulated price, effectively eating further into the margins of new entrants.

“... potentially an indication that the price setting is not reflective of the true cost to serve. One of the aspects of the price setting in the ACT is they don’t include costs that are included in other jurisdictions. For example my understanding is the current regime doesn’t include customer acquisition costs in the costs for determining the regulated price, which is a cost that is included in other jurisdictions. So that goes potentially to squeeze the margin for the retailer on the electricity side of the business.” (Inactive)

“So they’re going back to a regulated price, so you’ve got a state with consumers that don’t really have choice. And they don’t have it because there’s not enough companies there knocking on their door or calling them, giving them those choices, because we

⁶ Based on information within the Independent Competition and Regulatory Commission’s “Issues Paper – Retail prices for non-contestable electricity customers 2009-10”, p4.

don't have anything to offer. Because we're competing against something we can't compete against, which is regulated prices." (Inactive)

A couple of participants commented that it may be because ActewAGL Retail's bundling has declined in popularity or perhaps the mix of the products isn't what some customers want. A couple also suspected that maybe the regulated price was the only price put forward in some situations. One confirmed that when a customer's contract term ends, they are recommending the customer switches back to ActewAGL Retail because they are not able to offer a better price.

"Without knowing exactly what's going on, you could surmise that the bundle offer that ActewAGL are offering is declining in attractiveness to customers down there... I mean you can imagine if you've bundled the seven different products, it's like you're with Virgin. As long as you keep on adding another product on to that you'll keep your discounts, but once you step one step out, that's it, you're gone. And look whether electricity and gas is the big thing for ACT customers or it's the mobile phone, ISE or, or pay TV provisions, I don't know where people place better value on, on certain things. I mean certainly electricity and gas is a low involvement product. Pay TV seems a luxury so that product range they've got in that bundle, range in from being an essential service to being luxury service, so it, it just depends on how people view it. But that's only a guess." (Active)

"And in recent times customers that are coming off contract we're advising them to go back to the standing tariff, back to ActewAGL. We are one of the retailers that said to the ICRC that we are now advising customers that come off contract that we can't make an offer that is better than the standing offer that they'd had. ... So I think generally things changed in the market sort of mid, early to mid 2007 when the wholesale price went ballistic. At that stage we largely pulled back from our proactive acquisition activities and then progressively through 2007, 2008 we've reached this position that you can't actually secure a wholesale position that allows you to have a reasonable margin below the regulated rate." (Active)

"Well I think the margin with gas has been all right, the electricity hasn't moved to a cost reflective level as [colleague] was saying before. So from the market even three or four years ago, the wholesale markets have become a lot more volatile, and regulators - before that it was a much easier job setting prices because the wholesale markets were relatively benign, and from 2006 and '07 we really saw a change in the wholesale markets, and government has been very slow to appreciate that. So I don't know the exact margin numbers based off the wholesale because we haven't paid enough attention to it, but from all evidence I would say the returns have diminished rather than increased due to the increasing wholesale market costs that haven't been really reflected." (Inactive)

“Why people would switch back to a regulated rate is because obviously the market rates were higher. Why are the market rates higher? The market rates are higher because they’d be reflecting higher wholesale curved prices, which by deduction means that where the regulated rates are being set are either not reflecting where the wholesale market has moved or not reflecting a realistic margin... their process doesn’t deal with a wholesale market that’s moving around. For them to try and set a four year view or something it’s just totally unrealistic because the wholesale market’s not like that, and secondly, they don’t set realistic margins. The margins they set, no right business person in their mind would be able to make a business case ... So, if a whole lot of people have jumped back on the regulated tariffs that tells you the very issue for the market, why the market’s a flawed market. Because those retailers have had them on market contracts have spent money and time signing up the customer to come across, to then lose them. So yeah, poor business.” (Inactive)

Access to Competitive Market Offers

One of the questions that should be considered in terms of the effectiveness of competition is the extent to which any particular types of consumers may be less able to access competitive market offers – for example those from a non-English speaking background, people on low incomes, or those with special needs. There was little to no concern in this area among those interviewed. Indeed, only one retailer could point to customers that could potentially have less access as being those who are not home during standard door-knocking or telemarketing times, and/or who have “high fences” that restrict door knocking activity.

“I guess that when I think of sales people, I don’t think anyone’s safe.” (Active)

One retailer commented on small business customers tending to do their own switching. Because this retailer only uses online promotion via their website and an online switching service, they feel that small business customers are less likely to be exposed to their offers.

“...small business customers they’re often an ignored part of the market. The problem there is that they are less likely to move to arrange a connection using the sorts of channels that we’re involved in in the ACT, they often just do it themselves, they don’t do it as part of a move to a real estate agent and so on. Even when they’re moving into rented premises, they tend to arrange those things themselves. And when you think of energy in the ACT, you probably think of ActewAGL, that makes life easier.” (Active)

In terms of vulnerable customers, a few of the retailers interviewed assumed that because average incomes are higher in the ACT (in comparison to other jurisdictions), there are fewer particularly vulnerable customers. Almost half of the retailers interviewed stated that it is the government’s role to ensure that vulnerable customers are protected by appropriate hardship

programs (implemented by both the government and retailers), rather than via price controls, as the following quotes illustrate.

“The governments tend to be really concerned about vulnerable customers, and what happens if we take away price controls. The thing is that really, really truly vulnerable hardship customers are probably less than 1% of the base. So you’re keeping a cap on everything to protect 1% of customers. Let the cap go and put some extra effort into supporting those hardship customers. Put some requirements on the retailers to do something, and also provide some more government support, which is what should be happening, specifically to identifying them and supporting them. And then the 99% of customers who can pay for this stuff, and who should pay for what they used, do pay.”
(Inactive)

“It’s even interesting in the ACT, like the IPART has great concern about vulnerable customers and so on. There’s a lot of debate around that, but again my view would be that that’s a separate issue, that if you get a truly competitive market then people that are vulnerable there need to be protection mechanisms for those, but you shouldn’t do it by artificially suppressing all prices.” (Active)

Conclusions

Many of the retailers interviewed state that they have observed ActewAGL Retail engaging in a high degree of marketing activity, while other retailers are not actively marketing in the ACT. The lack of marketing by other retailers reflects their view that they are unable to offer more attractive products – essentially from a price perspective – which would entice ActewAGL Retail’s customers away.

Nearly all of the retailers interviewed were unable to identify specific groups of consumers in the ACT who they think may have less access to competitive market offers than other customers. Almost half of the retailers indicated that they support protection of particularly vulnerable customers from price shocks via targeted customer hardship programs (ideally with some form of government support) rather than via blanket price suppression across the market.

5.3 Competitiveness, Retailer Rivalry and Customer Switching

Perceived Level of Competitiveness

Retailers were asked to rate the extent to which they think the retail electricity market is competitive in the ACT for small customers. On a scale of 0 to 10 where 0 is not at all and 10 is extremely competitive, the most common response was in the vicinity of 3, 4 or 5 – six

participants rated it as 5 or below, although it did range from 0 up to an “8 or 9” (the latter from an active retailer).

“I meet with the Chief Executives of all the retail companies on a regular basis, and there's not a lot of talk there about, you know, ‘Isn't ACT a buzz?’. There's very little activity there. All the activity is in Victoria. We're all competing against each other aggressively in Victoria, but other states; some of them are in other states but they're just there keeping their position warm, hoping for when price deregulation comes in.” (Inactive)

“...the ACT market is, you know, effectively competitive. You know, we think it could be more competitive if the [Transitional Franchise Tariff] was removed ... according to the criteria that the AEMC uses rather than the more narrow set that the ICRC uses, then we think it's competitive.” (Active)

“Then it was interesting when, when the ACCC was trying to nail us on the fact of, ‘You're not in there because of someone's behaviour’. You know, we're very clear to say, ‘No, no, no. This isn't about someone's behaviour. That's a direct result of the market rules in an asymmetric market, where you can really get hurt if you haven't got things set up the right way’. So I think a lot of the times people are barking in the wrong place for, for what the challenge is. So we've found that there could be some suggestions; has there been good setting of tariffs there? You could have a question mark. It could be challenging if you've got someone that hasn't got the ability to manage risk efficiently and effectively. But I don't think we've had a discussion where we've said this: ‘We can't make a buck out of what we have down there’. It's just we're saying in the areas where there's, there's no price cap we can do better.” (Active)

“We have customers in all states, except for the ACT and that is purely as a result of the competitive nature in the ACT. We have a unique business model where we bundle [confidential]. This gives us a substantial competitive advantage over other retailers which has been taken up very enthusiastically which is good and we are expanding rapidly. The significant reason why we haven't expanded into the ACT is the ridiculous prudentials that ActewAGL have in the amount of money that they have require retailers to lock up in bank guarantees to pay distribution networks. That is a significant issue for us.” (Inactive)

“From my [previous role with an active retailer] days if you're interested at all, we certainly found it a very difficult market to crack, and [Actew]AGL was very aggressive in their defence of their customers. That's from a life ago...2004, ‘round about there...I think they just tried to put a lot of fear into the public around door knocking as a channel, and they had a big stranger danger campaign that they ran, that ‘beware who is knocking on your door’, and terrified old ladies, and things like that. So they certainly were very aggressive in that portrayal. But [previous company] certainly did make a penetration into the market, so like all markets people do churn.” (Inactive)

One main reason for the generally low level of perceived competitiveness according to the retailers interviewed is the market dominance of the incumbent which they essentially see as a direct result of the regulated price being too low for other retailers to achieve the margins needed to justify becoming active in that market. One participant also pointed out that the regulated price is based on the incumbent's price structure. Another commented that customers in New South Wales, by comparison, are paying "heaps more" for their electricity.

"And it's not only in the ACT that that's recognised as a problem. The AEMC certainly recognised it in other jurisdictions; it's just a chronic problem with retail price regulation; trying to let competition develop. [Colleague 2:] So, like you were saying before then, volume with high use could be the attractive thing but the margin itself is not that attractive." (Active)

"I don't think that there is a particularly effective market in the ACT. Previous regulators have suggested that there was already effective competition in the ACT, and that the price cap was no longer required. And I think that honestly if that had been listened to, the ACT would have been in a better position today in terms of the number of players in the market. It is a very small market, there's probably room for the incumbent and someone nibbling away at the edges of it, perhaps some sort of boutique provider, perhaps more in the area of small business or so on, where the higher margins are. From our perspective, the only channel that's worked in the ACT consistently has been moving home." (Active)

"Probably like all markets [FRC] really just allows competition to start. The thing that always restricts competition basically is that there's not enough margin for retailers to get a return on capital, and there's not enough access to wholesale electricity in particular, gas is different, but electricity, to risk mitigating against the wholesale costs. In each state where there's been price capping that's been unreflective of the real costs of operating the market you won't get competition, so ACT is not immune from that." (Inactive)

A key issue expressed by a few of the retailers interviewed is that the wholesale electricity prices have changed greatly since the introduction of FRC – both increasing and fluctuating significantly – while the regulated retail price has not increased proportionately. The retailers interviewed claimed that this squeezes the retail margins even further. Two retailers commented that this started in 2006 or 2007, and they think this has triggered a reduced level of competition as retailers struggle to compete and maintain the necessary margins in the face of the retail "price cap". One retailer suggested it was the drought that significantly affected the wholesale price in 2007. Other costs are also a factor, but the main problem from the retailers' perspective is the low regulated price.

"I think that the whole market generally changed profoundly in 2007 with the wholesale prices, the drought and you know, all the effects of that. I suspect that that changed a lot

of retailers' strategies quite profoundly. You know, with the huge price excursions that occurred in the wholesale market. So people that had positions that weren't well covered would have seen or taken a whole new view of the risk that was involved in being in these markets, and that meant then probably there needed to be more risk premium built into, you know, the margins that you were offering particularly in acquisition markets... I don't think the margin has ever been overly high enough for us to have an incentive to go in there and market. And I know that was one of the reasons at the time when FRC did open that we weren't in there from day one 'cause there wasn't really a need to ... It comes back to the regulated price and how that's set and ... the allowances that are determined within that. So it's not just a, the allowance for a net margin. It's the allowance for the energy purchase costs and whether they're accurately forecast and they can easily be set wrong which causes all sorts of problems.” (Active)

“From 2006 and '07 we really saw a change in the wholesale markets, and government has been very slow to appreciate that. So I don't know the exact margin numbers based off the wholesale because we haven't paid enough attention to it, but from all evidence I would say the returns have diminished rather than increased due to the increasing wholesale market costs that haven't been really reflected.” (Inactive)

There was a sense among some of the retailers interviewed that when the wholesale prices weren't so high, competition was higher than it is now. However, they added that competition in the ACT retail electricity market has never been very high and certainly not as high as it would be if price regulation were to be removed, or at least if the regulated price were to be increased substantially.

“I don't think it was until 2004 that we actually took the step in. When we did, because it's such a small place and there's an ActewAGL person that lives in every street in Canberra, they knew we were there within about 30 minutes. And we made reasonably good headway with customers down there, we had an offer. It was something that Actew hadn't come to them with. There was an alternative, there was an offering we had and at that time Actew wasn't making any offers at all, so they were relying on the base that they had all these customers and it was a closed shop. So we came in with a market that effectively offered a discount off the standing rates... We've found it's amazing for a very small concentrated place, it was hard yards. Very, very competitive market place. Back, back in, you know, three years ago you had Country Energy was doing a lot of stuff, they were hard to beat, and they were very aggressive, you know, all over the place, but especially there. And you had, you know, an incumbent that was very good at managing their business and brick walling their product offer and their clients.” (Active)

“The early regulatory decisions on price meant that there was a fair bit of interest shown in the ACT market, including ourselves. Subsequent, I think that's where the regulator got the idea from, that you can basically; well I think the regulator took the view that any potentially competitive market is effectively competitive, therefore why am I hanging

around in this space, the price will find an efficient level, with or without me. Since then there's been decisions that have tended to suppress the price. And there's also just been the technical difficulty of complying in the ACT. Most of that's around feed in tariffs, and some of the proposals they've come up with have sent us into a bit of a tailspin periodically.” (Active)

A number of retailer representatives commented on the fact that although there are only a few active retailers in the ACT electricity market, the presence of the inactive licensed retailers represents a constant threat to ActewAGL Retail. However, unless changes are made regarding price regulation, the inactive retailers have indicated that they are likely to remain inactive. Some of the retailers' feedback indicates that particularly in the early stages of FRC, ActewAGL Retail wasn't as active as it is now in its efforts to retain customers, and some customers did switch to other retailers, so the organisation has certainly experienced the effects of competition.

“I think you'd find part of it is the 19 licensed retailers continue to be a threat on the radar of ActewAGL, which keeps them sharpening their pencil all the time, and being mindful of the potential entry of new participants at any point in time. And I think some of the likes of the EA's and the TRU's and like have gone in and out in small chunks, and had little wins when they've gone in there to do that. And it is an attractive market given the gas load and the dual fuel aspect, and the socio-economic size of that market.” (Inactive)

All retailers interviewed are of the opinion that the level of competition would increase if price regulation were to be removed or the regulated price increased substantially.

“If it were totally deregulated I'd guarantee you would see it probably move to the eight [rating, out of 10], maybe even a bit higher. Because people would treat it on a campaign basis then, and it would be easier to operate and de-risk the wholesale side... if you're looking at just what this review could do to it instantly, spur competition, it would be to go to a price monitoring market as in Victoria, and that would instantly attract retailers in. I know it would attract us straight in.” (Inactive)

One of the retailers also commented that they expect competition to increase as a result of the forthcoming electricity privatisation in New South Wales.

“Looking forward I can just see this space including the Capital region, the competitive market continuing to be active, particularly in light of, if there's further consolidation, if there's a privatisation in the New South Wales market, and there's a removal of; and I think the New South Wales market will impact the ACT market, I think at the moment maybe the ACT market has benefited from the fact that the New South Wales market has been somewhat stagnant. However, if the impending privatisation goes ahead, and there's a lifting on the current ETEF arrangements in New South Wales, I think you'll see a completely, I would expect that there will be a significant ramp-up in the level of activity, which will have a direct impact into the ACT.” (Inactive)

A couple of participants pointed out that three of the four active electricity retailers in the ACT small consumer market are part or fully government owned, which they think creates some distortion in the market because government owned retailers are less concerned with profit than privately owned ones.

“The government owned retailers like Country Energy, Integral, and Energy Australia appear to have very little accountability for profitability in their own result, so they distort the market picture very heavily in New South Wales [and the ACT].” (Inactive)

“The costs to serve a small retail customer compared to the retail margin is simply not worth it unless you are a big boy who has years and years of government funding behind you to have pushed you through. This is in general but also true for the ACT market.” (Inactive)

Retailer Rivalry

There is little retailer rivalry currently evident in the ACT small customer electricity market according to the retailers interviewed. However, two participants observed that ActewAGL Retail is aggressively taking action to retain and/or attract customers – for example, through its significant advertising and community presence with sponsorships and education programs.

“So we came in with a market that effectively offered a discount off the standing rates. And we had some success in that regard. But Actew came back with a sort of win back campaign, for want of a better word. A win back campaign where they basically put ads in papers and things like that saying to customers, ‘Look’, you know, relying on the parochialism of the, of the area, and saying to customers, ‘Look stick with us, you know, we’re Canberra based, we’re here for you’; all that sort of stuff. So that was the sort of resistance that we found in the initial market. But, you know, we did have a good cut through and got a reasonable percentage in a short period of time. But then again ... there was other areas that we wanted to put our focus on, and again it’s a small jurisdiction. You get around the Territory quickly with the door knockers that you have, and we found that, you know, after we’d been through most of the territory two or three times, there was no point flogging it all... they’ve been able to find that right equilibrium between return and, and benefit for the, the community in terms of their product suite, you know. It’s very simple and very convenient what they have, which, you know, I find that hard to argue with. So there’s markets where I get [annoyed] going, ‘I’ve been squeezed out of there, I’ve never had a fair chance’. And there’s markets where you go, ‘They’ve never done anything that made it difficult for us to do what we wanted to do’. You know, so I haven’t seen anything where I felt like going, ‘That’s rubbish and why should they, they’re using unfair advantage or that’. I think they’re just really invested in a really sound business model, and leverage the fact that they had a, a special area. And I call it “special” because of the fact, you know, if I look at the activity we have in

Victoria, we might have gone through a million customers, knowing that, you know, we'll, we'll some stage get back through that again but we've still got other opportunities to do but I think that exhaustion of, you know, doing it once, doing it twice and then customers go, 'Geez when do you get the message, I don't want to talk to you'. So I think the market got exhausted very quickly there, 'cause it wasn't just us doing that, I think there were lots of other people doing the same thing.' (Active)

In terms of price-based rivalry, although the incumbent offers discounts on bundled services, the other retailers interviewed say they are not actively competing on price at present because of the low regulated price and the need to maintain their margins and minimise their risk. One retailer spoke of directing customers back to ActewAGL Retail's standard (regulated) offer when their contracts end because that retailer is unable to offer the same price. This retailer claimed that ActewAGL Retail is also actively seeking to acquire their customers, and succeeding.

"I really don't see any aggressive price competition in the ACT at all." (Active)

"In recent times customers that are coming off contract we're advising them to go back to the standing tariff... So if [ActewAGL] sit there comfortably with, you know, no prospect of competition eroding their market share, and they are in acquisition mode in [our] territory, there's an element I guess of unfairness about that. ... They are taking our customers." (Active)

The retailers interviewed think that ActewAGL Retail's non-price based rivalry is occurring in the form of customer service and market presence. This includes shopfronts, its dedicated call centre (One Call Connects All), bundling from the perspective of convenience (not just discounts), and its above and below the line marketing activities including extensive community sponsorships. Other retailers with customers in the market are thought to be competing on the basis of customer service. However, these retailers have stated that they are not actively competing for customers and are not running active marketing campaigns.

"We got down there and went through a sales, initial sales round yonks ago and they've just stuck with us 'cause we haven't done anything to upset them... I just think they'll be doing exactly the same thing saying, 'Look at the size of the prize, degree of challenge in terms of, you know, growing there'. For your spend you're going to be able to get probably three times as many customers than investing it in, in defending and growing an ACT business... I would be surprised if anyone's proactively going hard there." (Active)

The inactive retailers interviewed were not really aware of the extent of rivalry between retailers essentially because they are not participating in that market.

"I have no knowledge or view on how the incumbency specifically works up there... I just know from my previous experiences that unless, depending on what other things are going on in the marketplace, people are not particularly, if there's not a huge price

variation or something else going on that sort of forces them to make some decisions about choosing, they're less likely to do that. That's why door knocking's quite, aggressive door knocking does work. ... And I think that because ActewAGL's, in Victoria there was so many changes in the names and all the retailers and all that sort of stuff, over a bit of time, that people were a lot less, they don't have that sense of loyalty. Whereas it's very different in the ACT. And it's for more than just gas it's water as well. Which is, there's no competition. Nothing specific to ActewAGL, but they are incumbent in three, the three utilities. So they've got three access points. Three plus Telco, whatever Telco stuff they're able to get in there as well. So, you know I think that gives them a great position of strength. You know it's a lot harder to dislodge customers unless they've, unless there was a significant price difference, or the customer had a specific issue with ActewAGL. And as I said, it's also a historical, they've been doing that for some time.” (Inactive)

Customer Switching

Based on what retailers have stated, there does not appear to be much customer switching between retailers in the ACT. In fact, a couple of retailers stated that the only switching they are really aware of is customers switching from a market contract back to the standard offer (that is, returning to the original designated retailer). There is a concern among these retailers that this customer movement may look like switching between retailers when it is actually a false measure of competitiveness.

“Probably over-represents competition because a lot of the switching would actually be customers going back to regulated tariffs. So it looks like people are churning but really they're churning back to where they started...I think people look at the churn statistics as a measure of competitiveness, but when that's happening it's really giving you a false measure of how competitive a market is.” (Active)

Quite a few participants stated that the number one reason customers switch retailers is because they have found a better price. The second most common reason is because they are moving house and the third reason they identified is bad customer service experiences. This is not seen by the retailers interviewed to be unique to the ACT. In the case of retailers not being able to offer a better price than the regulated one, some of the retailers indicated that it could be expected that there is only limited switching. A few added that the key to customer retention and loyalty is customer service.

“In those early years we also used to do exit interviews which again showed that price was the key determinant of switching, that service was a key determinant in retention.” (Active)

“I’m aware of universal differences, which is that small business customers are actually less likely to switch than residential customers, but I’m not sure if that’s necessarily the same in the ACT, I assume it was.” (Active)

“Generally as a general rule most people need about a 5% discount to switch, or 5% less than what they’re currently getting. Less than that you don’t get much.” (Inactive)

In terms of moving home, one retailer commented that they consider that there is a high level of transience in the ACT population.

“Canberra has a very transient population so, when customers move house, we direct all the calls to X and we capture everyone who comes in and out of the market through that and try to re-sign their services at their new premises ... so we’re finding that a lot of new companies are doing that – like there’s a lot of switching companies that have really come to surface I think over the last twelve months ... you know when people move homes and then the first thing they want to do is they go oh, we need to get our electricity connected ... and you know previously that was the phone as well but now with people moving to mobile phones, you don’t find people necessarily make that first phone call to a phone company anymore; it’s really to the ... um, I must get my electricity and gas connected.” (Active)

One participant pointed to broader contextual considerations about switching behaviour across all of the product categories that a consumer engages with. That is, there are probably other service categories, apart from energy, that would offer more benefits from switching suppliers in terms of larger cost savings, such as car insurance.

“I don’t think there’s any technical barriers to switching, it’s just really just a question of the ‘WIFM’ principle, what’s in it for the customer. It’s a low involvement product, low interest category. I would suggest that around 5-6% of household income is spent on energy or electricity in particular, but there are more compelling things to look at. And for the sake of saving a few percent here and there because the margins are so slim, most people can do better on their car insurance; if you are going to do one thing a year in terms of shopping around, I don’t think you’d do it necessarily for energy. So car insurance and others have a fairly compelling proposition, guarantees to save at least \$140 or whatever, we just don’t have that at the moment.” (Active)

One of the active retailers noted that they haven’t observed a strong switching propensity in the ACT, with customers generally staying with them, and not really even asking about better offers.

“But the funny part is we haven’t had our customers going, ‘Yeah it was good for a year but we’re going. See you later’. So we’ve been quite passive in ACT for a period, and we haven’t seen a haemorrhaging of our customer base in that respect. Notwithstanding it’s small, it’s been quite orderly... The point I was making was if we started having people saying, ‘Hey can I have an offer? We heard that...’, and there was a low

involvement way to do that, we'd contemplate that but we haven't even had the calls. I haven't got any, seen any feedback about it, about people asking for offers." (Active)

Conclusions

According to the retailers interviewed, competition is not particularly effective in terms of overall retailer rivalry and anecdotal customer switching behaviours. This appears to reflect retailer concerns about the low regulated retail electricity price, the high wholesale prices and the resulting possible retail margins. Some of the retailers think that ActewAGL Retail is genuinely working hard to retain customers and is itself demonstrating competitive behaviour, in response to threats (real or otherwise) posed by other retailers.

5.4 Catalysts and Barriers to Market Entry, Expansion or Exit

Participants were asked about the catalysts and barriers associated with entering the ACT small electricity consumer market, expanding operations there, and even exiting the market, relative to the impact this may have on the effectiveness of competition.

Catalysts

There are various attractive features that the interviewed retailers see in the ACT small consumer electricity market, as follows (in descending order of frequency of mentions):

- Although the market is comparatively small against others in the national electricity market, there is a sense that there are enough consumers to make entry viable, with a general sentiment that a few thousand customers is enough to warrant pursuit, provided that the regulatory conditions are acceptable;
- There is a particularly large demand in winter, and a smaller peak in summer;
- Higher incomes – seen as beneficial both in terms of propensity to use more energy, but also less likelihood / incidence of credit issues;
- The fact that the market is compact geographically which presents logistical benefits in terms of mobilising sales teams;
- The fact that the feed-in tariff exists as an option for customers where this does not exist in other markets, with one retailer commenting that the tariff is quite reasonable; and
- The ability to provide electricity and other services to politicians and government decision makers and potentially raise their corporate profile.

“But specifically about the ACT I would say that it’d be, from our point of view a critical mass would be a very small number of customers ... A few hundred, 500 say.” (Active)

“There’s no such rural areas; you can drive from one end of Canberra to the other end of Canberra in half an hour, so... geographically, there’s no restrictions and it ... we’re so close-knit ... I think that’s ... that’s actually one of the dangers is that you know it is ... it is a threat to me that it’s really easy to canvas Canberra. Very easy to door-knock. You know, you’re not competing against different advertising footprints, if you know what I mean, like the TV signal substation ... is everywhere.” (Active)

“I think an initial catalyst would be the higher on average consumption, just having the cold and hot climate; very cold in winter and very warm in summer, so you get more through-put in average. So, perhaps you know that might ... that might therefore attract a competitor to come in and think well okay if I can pick up a margin on volume. I prefer higher volume than low volume and going around door knocking and all that, so certainly that would be a factor ... I think an important one. There’s also then the fact that, not tied just to the weather but also the incomes would drive potentially higher consumptions, obviously there are demand management tools in place, the drivers in place, just having more income, perhaps being able to then use more energy intensive appliances and equipment again drives up consumption.” (Active)

“I think the demographics are strong in the ACT in that the average household income is probably higher than average, and so it’s got some socio-economic demographics that make it a stronger market, so credit is less likely to be an issue in the ACT.” (Inactive)

“There’s probably a greater polarisation in the ACT, I think a lot of people don’t realise that it’s not a particularly high income area, despite of the prevalence of the public service there, there’s a substantial welfare population in the ACT, and they are customers who can make significant drains on the resources of companies such as ours in terms of credit risk.” (Active)

One of the other basic reasons why many of the retailers said they have gained a licence in the ACT is to enable them to make the claim that they are a national retailer. This is seen as especially important to smaller retailers wanting to be able to compete on more of an even keel with some of the larger retailers. Five of the six inactive retailers interviewed indicated that they intend to become active in the market when conditions are right.

“So because customers like to know and feel that you are a big national company, big retailer, before they want to do business with you, because you're always being compared to an Origin or an AGL or a TRU, because they have the national presence. So therefore it’s important to have retail licences in other states so that you can actually make that claim that you're national. And the others do the same.” (Inactive)

“Activity in the ACT for us as we’ve said has been very quiet, so it’s more coming off other national contracts in there, the larger sort of customers, they’re not residential.”
(Inactive)

One retailer that currently has a customer base in the ACT but is only passively in the market commented that they are still there because it helps their ability to use the relatively low-cost moving home channels for marketing across other states.

“We have an agreement with moving home channels, and that’s where our current churning is generated in the ACT. And that’s not because we consider the ACT a particularly lucrative market, it’s more because the national network of real estate agents and so on, who deal with that, do not want the headache of exclusions and exceptions and so on. So we offer a service in the ACT and in NSW, through the moving home channels. That’s pretty much it. And also inbound sales, so if someone rings us and wants a connection, we will provide it. And if someone gets on the web and wants a connection, we’ll also supply them. And they’re relatively low-cost channels to market.”
(Active)

Notably, a few of the retailers commented that the dominance of ActewAGL Retail in the market could be seen as an attractive factor in that the competition is a known quantity.

A key driver associated with market expansion is essentially a desire to grow the business. Long-term continued price regulation was the primary catalyst that the retailers who were interviewed felt may prompt them to exit the market, specifically at a level that continues to make entry unjustified from a retail margin perspective. Only one of the retailers interviewed was currently actively contemplating exiting the market, saying they would do so if the prudential requirements are not significantly reduced.

“Generally the only reason you exit a market is you weren’t making any money. And if they didn’t have a sufficient customer base for the regulatory compliance and some of the other bits, but I would have thought that was a pretty poor excuse. I’d say the main reason would be, and I couldn’t say what they’re doing, but it would be because they couldn’t make money from the customers that they had there. Generally when you’re making money you’ve got no real reason to stop making money.” (Inactive)

A few participants commented on the higher concentration of politicians in Canberra, with one stating that it is attractive to some to be able to provide electricity to them, as decision makers.

“In terms of political visibility I guess the market is an attractive. Political awareness and you get reasonable interaction with the government. It is always good to be operating in their backyard of people you are doing business with. That is one attractive feature of the ACT.” (Inactive)

Barriers

The retailers interviewed do not see particular barriers in terms of gaining and maintaining their licence in the ACT.

“We had to get our systems compliant to be with ACT. There are licence fees and certain compliance, but it’s not huge in the scheme of things.” (Inactive)

The regulated retail electricity price for small customers is the number one factor *by far* that is inhibiting the retailers interviewed from actively engaging with or expanding in the ACT market. It is seen to be too low to enable them to achieve the required margins and to be able to offer customers competitive prices and thus justify their entry or expansion in the market.

Many of the ten retailers interviewed spoke of the fact that they also have to carry the wholesale price risk. For the inactive retailers in particular, this risk is considered too high when the ‘fixed’ retail price does not reflect the variable wholesale price.

“Your wholesale price is a variable price, and your regulated price is a fixed price. So everybody has got to manage the wholesale prices that fluctuate through on your cap, that’s the issue ... the retail cap doesn’t have any bearing on the wholesale price, the two are disconnected. That risk is borne by the retailer.” (Inactive)

“I think we could offer a market rate, provided the market rate had adequate margin for us to run a retail business, and I think that if we sample the product with an adequate margin, a market grade product, it would be probably higher than the regulated grade, well it would be, not probably, and would make us uncompetitive. So, you know, very hard. That’s why we’re not there. That’s the fundamental reason we’re not there.” (Inactive)

“...not that there are fundamental barriers to entry since anyone can do it, but maybe the TFT [Transitional Franchise Tariff] being set at a level which I also think the ICRC acknowledged, at the level which doesn’t provide the best margins.” (Active)

A number of retailers interviewed stated that they see the market as flawed in that the fixed regulated retail price does not reflect the true cost of electricity, specifically in terms of the variable wholesale price, which is subject to significant fluctuation depending on electricity supply and demand, and has risen substantially over the last few years – specifically since 2007. As a result the market is not privy to price signals that reflect the value of the electricity, and inactive retailers do not perceive advantages in entering the market. For example, EnergyAustralia has commented publicly that:

“The current 5% (the margin allowed as part of the regulated Transitional Franchise Tariff) retail margin does not adequately reflect the risks or cost levels faced by retailers and as such does not encourage a competitive retail electricity market within the ACT.”⁷

Similarly, many of the retailers interviewed stated that the fact that the market is regulated makes it a barrier to entry, with one commenting that this is what makes it a flawed market, and many pointing to the Victorian market model as the one that is the most competitive.

“But the ultimate thing that would drive us into a state is full market competition ... and what I mean by that is the Victorian model where price caps are removed and the market is a true market. Any market that has price controls on it capping a price, but a wholesale market that is flexing, is an imperfect market. And we saw this two years ago where the market got distorted, where people are being regulated to make a loss. So as long as that situation remains, you’d look at it and say, ‘Well, why would someone enter that market? Because it’s not a proper market; it’s a fools’ market. It’s a halfway market’. And a national agenda was meant to have brought full retail competition to every state in the full sense. Victoria is the only state that has done that and hence why they’ve got the most competition. So ultimately, ACT needs to move to full competition like the Victorian model... What’s attractive for us in a market is a proper market structure. So what’s not attractive is a market that’s a flawed market design. So it’s not an attractive market because it’s a flawed market design.” (Inactive)

Representatives from one inactive retailer described in detail some of the factors involved in pricing to illustrate how little room they think there is to move. This retailer commented that after wholesale and network costs of up to 90% of the retail price, which they are unable to control, retail costs represent around 5% of the total electricity bill. In this retailer’s view, this provides little opportunity to recover their costs and earn a satisfactory margin.

“You have to have something to discount. When you knock at the door you know in order to attract a customer, especially away from ActewAGL that’s got this multi product billing mechanism, to attract them away you have to offer them something interesting. And let’s say that that’s say a 10% discount, if you’re going to have to offer them a 10% discount there’s got to be more than 10% margin there, otherwise you’re losing money. But then even then you’ve also got to cover the costs. So if you’re going to pay a doorknocker \$100 to go and sign the customer up, let’s say you advertise that over three years, you’ve got another \$35 you’ve got to find, so you have to have enough headroom to then say take off the doorknocking fee, take off our management fees, take off our

⁷ Energy Australia, 2010, *Submission on ICRC Issues Paper – Retail prices for non-contestable electricity customers 2010-12*, p2.

costs of establishing the brand, take off what you give back to the customer, and we can still make some money.” (Inactive)

“The other thing too is I think frequently overlooked with retail pricing and deregulation of retail pricing, is the fact that in a bill 40% to 45% will be wholesale costs of electricity, which will fluctuate dramatically in weather conditions, and peaks, and all that. But we’re in the business of managing those risks. Then you’ve got network costs, which are another 40% to 45% of the costs, which are regulated by a national regulator, and it’s a motley business, and yes you need a regulator there because you can’t just go and build a couple of pipes next to someone else’s or poles and wires, that’s not economically efficient. And then you’ve got retail costs, which are normally 5% of the total bill, which are very, very small, but very powerful in how much the consumer gets exposed to, and how much innovation and choice that they can get. And if a regulator gets it wrong there’s not a lot of margin for us as a retailer to play with, it can very quickly trigger us to be totally disinterested in the market, or for it to be quite an exciting market.” (Inactive)

One retailer specifically commented on how surprised they were about how low the ICRC’s most recent pricing determination (for 2010-2012) is. They went on to add that in their view the price has been suppressed in the ACT and by comparison, customers in New South Wales pay a lot more for electricity:

“I think just in terms of the headline numbers that did come out in that determination I found them quite surprising how low they were, the overall average change in retail prices. Given what I know about what’s happening underneath that retail price, I was a bit surprised at the change there. It’s only two and a bit per cent which is a tiny, tiny increase....In New South Wales they pay heaps more ... I think historically too ACT probably started being, having an association with the Snowy, like when the Snowy was built and there was probably some special deal done that sort of artificially suppressed the wholesale prices flowing into the ACT. And as the market has opened up, that [the] regulators in the ACT have been reluctant to quickly take, or even slowly take in some cases, the customers to sort of the true market level.” (Active)

As mentioned earlier in this report, a few participants added that the regulated price does not have provision for customer acquisition and retention costs and is based on the cost structure of the incumbent, both of which are perceived as issues impacting on the achievable margins.

“The dilemma for us is that the price has been largely set around the incumbent’s cost structures, and that doesn’t make allowance for the cost of churn in the marketplace. So if you can be like an incumbent, and people just come to you and then sit there, then that’s okay, we can make the same return as the incumbent can, possibly better, we’re probably more efficient. But if we’ve got a high cost to acquire through another channel, where we’re outbound telemarketing at say \$70 or \$80, or doors at \$120 to \$190, then there’s just really very little scope for customer acquisition in the ACT with residential customers.” (Active)

“The distinction there is, perhaps it is an important distinction, is that I don't think the ICRC specifically have [acquisition and retention costs] as a cost allowance. ... Whereas IPART by contrast has made that an explicit part of the cost build-up.” (Active)

“...we do have costs of going and acquiring new customers, and that's not currently recognised the way the regulator puts the pricing together. So if you want to encourage new entrants you have to recognise that there is - I guess the incumbent has an advantage if you're not recognising that cost of acquisition of new customers.” (Inactive)

The retailers interviewed outlined a range of lesser barriers, as listed below in relative order of significance in terms of frequency of mention and strength of sentiment:

- ActewAGL Retail – both in terms of its dominance of the market as the incumbent, as well as its bundling power across utilities (mentioned by most). Notably, retailers respect ActewAGL Retail and the work it is doing in the ACT;
- The fact that the ACT has its own regulations that are different from other jurisdictions, which creates additional compliance and administrative costs, which most of those interviewed mentioned (e.g. call centre programming and staff training) – these are also seen by some as disproportionately high relative to those of other jurisdictions;
- The relatively small size of the market – most mentioned this;
- The requirement to administer the feed-in tariff, specifically because of the associated costs to do so and the fact that other jurisdictions do not offer this – some mentioned this;
- The prudential requirements of ActewAGL (3 mentions by smaller retailers), where one small retailer described the bank guarantee as being more than ten times the amount of the next most costly jurisdiction;
- Inflexibility in how ActewAGL negotiates the network user system agreements (2 mentions);
- For one retailer, a lack of existing brand awareness or presence in the market; and
- The requirement to offer a green energy product (1 mention).

Retailers generally found it difficult to prioritise these lower level barriers and tended to see the combination of these factors as inhibiting and inter-related. Some of their comments are provided below to illustrate their concerns.

[Regarding the ACT having its own regulations] *“...everything from the number of days that must lapse before you issue a second bill, or you can send a reminder notice, through to the requirements on distributors to provide services to retailers such as connections and the timeliness within which you must do it. Because it's hard in a call centre – call centres run on procedures and processes, and permutations and combinations are not good for stable procedures and processes. It's not impossible, don't get me wrong, but I would doubt that if you looked at it from the point of view of standing on the outside looking in, where's the consumer benefit? And if there isn't*

actually a consumer benefit associated with those differences, then why regulators persist with them is beyond me.” (Active)

“I guess as another barrier I would say, and it is in no way unique to the ACT market. Is like everywhere state they’ve got their own sets of criteria for everything. Reporting requirements, licensing and contracts requirements. And obviously quite a large overhead for a retailer who has to maintain differences for every state. Processes to deal with them.” (Inactive)

[Regarding the prudential requirements:] *“It is basically saying if you are not from a government owned company, don’t come to the ACT. A majority of them are government owned companies so they by default have the credit rating required. There’s not very much competition I think really happening from a sense I get from the other retailers who just get into the ACT because of the completeness as opposed to it being a large interest within their companies. ... I don’t get the sense there is any real share of trying to get market share from Actew at all. It does seem to be a completeness thing and they are offering, regulated retail with a bit of a discount or movie tickets or something. There are no campaigns that are trying to break into the market. It is literally as I say offering it for completeness and if they got somebody who is moving from NSW to the ACT so that they can continue their contracts with them they have a retail license there.” (Inactive)*

“Well, the issues around them for us would be really the prudential requirements that [ActewAGL Retail] want, which are sort of pretty onerous. And the inflexibility in how they negotiate the network user system agreements, which are pretty much ‘sign here’. They’re non-negotiable. That’s an issue in all states, not just in the ACT.” (Inactive)

[Regarding feed-in tariffs:] *“They have some problems in the ACT obviously with feed-in tariffs, so we get caught out by that periodically. Firstly through administering them, so where a customer requires reimbursement under the scheme, and secondly they tend to make customers less attractive generally due to the rigmarole involved in it ... because the whole account has to be managed by exception.” (Active)*

[Regarding feed-in tariffs:] *“It’s a complex operation and you’ve got to set up your billing system, so we’ve got our billing systems set up so we can you know do the maths and deduct and add and subtract and all those kinds of things, so it’s um ... again, it’s not a cost that is covered under the regulated tariffs, so not compensated, so It’s something that we ... it’s a cost that we incur ... and then for your actual usage you get billed at the rate that’s published so then ... so the billing system needs to be able to... measure how much you’ve actually generated versus how much you’ve actually used ... and then puts you in a credit or a debit position ... like we’ve got people who answer phone calls andyou know the cost of setting up the website. We have incurred in a training ... so we can train our staff on what the feed-in tariff is so there’s actual true cost associated with it.” (Active)*

[Regarding a lack of presence:] *“We have no presence in that marketplace, no one knows us, and we have a main competitor who owns the majority of the marketplace, ActewAGL, where Actew is a brand that’s existed there for decades. Well known, well respected, well loved... So you’ve got the size of market is against us, regulatory system costs are against us, brand is against us. Product offer? What could we do in with in terms of product? Well we’ve got a great range of products that work well in other states, but they’re electricity and gas, and you’ve got ActewAGL that can do multi utility, we can’t match that. So small scale market, regulatory and systems costs high, branding is difficult, product offer is difficult. And then you go ‘but is there still an opportunity because there’s money to be made?’ No, there’s regulated pricing, and there’s no headroom. So the discussion doesn’t really go any further.” (Inactive)*

[Regarding green energy and regulatory compliance costs:] *“[We would like to] Not have to offer other products that we’re not particularly interested in. So, you know, forced green products, forced dimension standing contracts. They sort of flow in more, so with that sort of ability to not have to have different processes for different states. If I’m operating in all states I’m, it might be 5% of my telephone calls come in for the ACT. It’s very hard for me to train my troops to handle 5%. You know those differences, which makes compliance difficult and nervous.” (Inactive)*

“The ACT to its credit has tried to not differ itself too much from other regulatory frameworks in other states, but things happen and things do differ. So you do need to go to exactly the same effort and make sure you’ve got different material for each state that you operate in.” (Active)

“Of course [ActewAGL has advantages]. They’ve got all the customers to start with. [Colleague 2:] And they don’t want to give them up. [Colleague 1:] So they’ve got massive advantages. Actually ActewAGL probably don’t have the hate factor that a lot of other incumbent retailers have, they seem to have managed things fairly well in the ACT to their credit. So we normally can - we normally do get customers who don’t like their retailer much, probably wouldn’t be quite the same there, but at the end of the day people switch for money. There’s not very much brand loyalty stuff, there’s no worries there.” (Inactive)

In relation to barriers to exiting the market, very few of the retailers interviewed could see any. One retailer stated that it would not be a wise branding exercise to ‘walk away’ from customers and another stated that not being able to ‘sell’ their customers could be a barrier from a legal perspective.

“So electricity’s a little bit unique in that if you can’t sell or assign your customers, you can’t just get rid of your customers. We’re unlike other industries where you come to the end of a contract and you say, ‘Well, that’s it. That’s all done’. Well no, that’s not it, in the energy market ... that person is still with you, so even if I don’t want you with me, you might still stay with me. So depending on the legal question, there could be a barrier to exit, yeah, if you just can’t sell your base.” (Inactive)

“There’s only some costs, which is the fact that we’ve invested in compliance. In terms of break costs, no, from our point of view. There’s a difficulty around just walking away and leaving your customers, it’s not something you do as a sensible brand exercise, so you don’t just write to people and say; ‘We’re no longer going to supply you unless you have absolutely no other option’.” (Active)

Conclusions

The ten retailers represented in this research have indicated that the barriers to entering the ACT market in terms of gaining and retaining a retail electricity licence for small consumers are low. However, these retailers see the barriers to becoming active and expanding in the ACT retail electricity market as clearly outweighing the drivers at present. Otherwise, many indicated that they would be actively competing for customers there. This is impacting upon the extent to which they consider the market to be effectively competitive.

There is a host of factors that retailers have identified as holding them back from actively engaging with the ACT retail electricity market, most notably the low regulated or ‘fixed’ retail price in the face of high, variable wholesale costs (especially since 2007) and the exclusion of customer acquisition and retention costs from the regulated price.

5.5 Future Directions

Participants were asked what they think the future holds for the ACT retail electricity market for small consumers, in terms of retailers entering or exiting the market. They were also asked what they would like to see happen, including if and how they think retail price regulation should be removed. Interviewees were also asked about whom they think is responsible for facilitating competitiveness, and any other issues that they consider may affect competition in this market.

What Retailers Want

Most of the retailers interviewed stated that they want to see the removal of price regulation. This includes ActewAGL Retail; as per its public submission to the AEMC's *Issues Paper*.⁸

“ActewAGL Retail considers that continuing retail price regulation in the ACT threatens to undermine the ongoing development of competition. This conclusion has also been made strongly by the ICRC in each of its reviews since 2006. Given that the market is competitive, the regulated retail tariff should be removed, as it has been with gas in the ACT since 2002, allowing customers to capture the benefits that can arise from a market free of regulatory constraints.”⁹

“So as long as the government doesn't interfere to make aspects of the market uncommercial, then it will find its own natural sustainable level, because you'll have a business or you won't have a business.” (Inactive)

“We should be moving to a world where there's less reliance on regulated prices and more reliance on the competitive market.” (Active)

Some of the retailers commented that removing price regulation would be far more preferable than implementing a stepped approach to phase it out. For example, they felt that if the regulated price were to be retained, it would have to be dramatically increased to be an effective interim measure. A few of the retailers interviewed indicated that a staggered increase in

⁸ AEMC 2010, *Review of the Effectiveness of Competition in the Electricity Market in the Australian Capital Territory*, Issues Paper, 4 March 2010, Sydney

⁹ ActewAGL, *Review of the effectiveness of competition in the ACT electricity market: ActewAGL Retail response to AEMC Issues Paper*, April 2010, p1. Source: <http://www.aemc.gov.au/Media/docs/ActewAGL-c2d915ee-6055-4de9-8e88-26a02153bc6c-0.pdf>.

pricing, beginning immediately, would help protect the market from the shock that would be produced by a single-step approach to more cost-reflective pricing in the future.

Some retailers suggested that the transitional step of increasing the regulated price could be skipped. They suggested that the regulated price be removed altogether to allow the market to regulate itself. While the government could redirect efforts to delivering appropriate safety nets for vulnerable customers. Indeed most of the participants pointed to the Victorian electricity market to exemplify the case for removing price regulation, stating that it was now the most competitive market in the world.

“The only state that has deregulated pricing at the moment is Victoria, and the way it worked in Victoria was the regulated prices were stepped up significantly to where they needed to be, there was flexibility given to us in terms of rebalancing tariff structures around an average, so it wasn’t ‘Here’s the flat price for everyone’, it was ‘Here’s the limit on average to the pricing, but you can play with your tariff structures so you’ve got some variation and some mobility to do things a bit more cost reflectively’. In raising those prices they created enough headroom to attract lots of competition, which meant that when the AEMC did the review there was lots of effective competition, and the government then had the evidence it needed, lots of choice, lots of innovation, to take away the caps. The thing in the ACT is until you get that - I mean, if the findings here are that there is not effective competition, the pricing still needs to be looked at to create the environment where you can get the competition in order to then be able to take the pricing caps away, which is a really silly way of doing it, because you could just take the pricing caps away and you’ll get the competition, but that’s the way the process has been structured.” (Inactive)

“I think the ICRC could also do with adopting a similar terms of reference to what IPART have adopted in New South Wales, in that we should be moving to a world where there’s less reliance on regulated prices and more reliance on the competitive market.” (Active)

“The fact you have got a non-competitive market and a flawed market should be telling them to say, ‘You have to change things to make it a competitive market’. Don’t look for the sign of a competitive market to then say, ‘Right, now we can move to price removal’, because you’re never going to get past base one of a competitive market unless they either remove price controls or go and crank up the margins by, you know, prices by about 30% or 40%. So ... we’re now two years more down the track from probably the last time we had a discussion like this [about South Australia] with someone and I think they’ve now got some evidence to suggest that their thinking needs to be looked at as a process because waiting to prove a market’s competitive, ... as I said to you today, South Australia’s not competitive. We aren’t active there. We’re two years on from when we had that discussion so if nothing changes, we’ll be sitting here in another five years and SA still won’t be competitive if it’s a price controlled regime. What they need to be looking at is more, ‘What are the things we need to change in the market to make it competitive?’.” (Inactive)

“Just do it. Let’s not have too many reports, and ministers interfering, and whatever else. Do it from a logical point in time.” (Inactive)

A few participants expressed more conservative views, indicating that they think price regulation may still need to be phased out over a period of time.

“So some states have moved to a more cost reflective cap mechanism, so that would always be our fallback position, that if you can’t get the competence to let the market manage itself, set the prices to a level that allows people to make a return or achieve at least some competition there.” (Inactive)

“A government cannot step off price regulation and have prices rise, so they need to put in place a transition where they create sufficient headroom in their price decisions, so they make allowance for the cost of acquisition, they make sensible allowance for cost to serve and so on, not based on some assessment of the incumbent’s legacy. And then they see competition start to develop. ... If they’re there to transition to a competitive market, then the way that you do that is by increasing the price to beat, until you don’t need it anymore... If the regulators tried to replicate what the efficient price is, then we’re never going to see competition evolve... At this point in time a pretty gutsy regulator could argue that there’s a substantial number of licenses, there’s a substantial number of offerings in the marketplace, it’s potentially competitive, therefore we don’t need to be here anymore. Because if it’s potentially competitive, it’s going to be competitive; there’s low barriers to entry and so on. So that’s one step. But if you are going to take it the way other regulators seem to, you would do the former and say we’re going to have a price path that captures the high end of what’s plausible, what those costs are, and urge people to go to the market. So instead of saying we’ll protect you, we’ll say the market will protect you. And I think that that’s a more sensible approach, and then at the end of a period of time you can step off. I don’t think there’s really an opportunity to go to price surveillance as an interim measure, because what will happen in the current climate is that prices will rise fairly sharply, and then the obligation will be on a price surveillance authority to actually do something about that. So being realistic, they’ve got two options, one of them involves putting a bit of a red target on yourself, and the other one involves what IPART has had to do in New South Wales to some extent, just getting realistic about how you are going to bridge the gap between where you’ve got yourself into, and where you need to be.” (Active)

“I don’t care about price caps as long as the person that’s setting the pricing level is taking a realistic view of what’s reasonable for a retailer to charge a customer. Not create an artificial efficient retailer that’s, you know, sub cost. So, when I want cost reflectivity I want cost reflectivity that’s fair, not cost reflectivity that enables me to embed scarcity pricing into the product. And I think that’s one of the dilemmas we’ve still got with markets. I don’t see why if there’s competition happening you shouldn’t care that there’s price caps there.” (Active)

What Is Expected to Happen

There was a strong sense from the retailers interviewed that, in the advent of the removal of price regulation, inactive retailers would soon enter the market and some would scale up very quickly. There was not a strong sense among those interviewed that existing retailers would exit or that a significant number of new retailers would become licensed. References were made as to what has occurred in Victoria and Queensland when price regulation changes have been made, to provide evidence of how quickly retailers may respond to changes in retail price regulation.

“I think the only way you will get the market to change is that headroom being right to bring people in so that the costs of those other barriers are overcome. Like they’ve done in every other state when they’ve run the FRC, is you make sure that they have - You can see it, if you look at Queensland it’s peaked and troughed according to the way the pricing has been set year-on-year. So when the pricing gets not done very well by the regulator all of a sudden people back away from the market. And it’s very quick, people can turn off their activity in a market within days really, and then you watch the churn slide, and then next price reset comes, or there’s signaling around the draft determination, all of a sudden people start ramping up and coming back into the market again.” (Inactive)

“One of the main differences in our model is the power of our sales channel that we have, we have the world’s biggest direct sales company on exclusive contract with us, so as far as the speed of acquisition that we can go, when we decide to go it tends to be quite high.” (Inactive)

“Once you’ve got [price regulation removed] your secondary issue is wholesale liquidity, that’s not an ACT issue, that’s a New South Wales node issue. But if you go to a price monitoring regime then at least retailers could manage the wholesale risk on that side. So the biggest tick item is a pen stroke basically, and move to that regime rather than one where you’re trying to determine a price. [Colleague 2:] There’s nothing else that really stops us. You know, the regulatory regime down there is quite stable... I would go in there and have a constant presence, absolutely. We would want to grow in [the ACT], just like we do in Victoria. In fact, we want to grow throughout all of Australia.” (Inactive)

Many of the retailers interviewed stated they do expect that retail prices would probably initially rise as a result of the removal of price regulation, as it would enable retailers to price electricity so that it is more reflective of the true cost – particularly on the wholesale front. Most of the retailers interviewed think that this would be the trigger for them to either enter the market or start actively marketing again.

“So if I can, you know, make the same unit margin in the ACT as I could in Victoria, you’d then be saying, “Well, you know, maybe for the investment of the activity I’m going to get a better return in Victoria.” And I think that’s it. The dilemma of the small states expecting the same outcome, it’s always going to be challenging and problematic for me to be able to cover my overheads of all the things we need to do well in that State. But I think if you got to the stage where, you know, price caps didn’t exist and someone was charging over the top; we would see that as an opportunity to come in there and, you know, probably turn the tap back on and make an offer. So we’re always looking at all our potential markets, about what we could do. At the moment we think it’s, there’s not a lot of head room down there, but if someone says, ‘Great, the way we encourage competition is put a lot of head room in there’, you’re going, ‘Well, you’re kidding me’. And I think that’s a problem I have is most retailers would tell you that’s their site. Churn is not the thumbs up to me about competition I think. My view is that when you’ve got a market where you have got a competitor not using their market position, but have got a really strong product offering that’s compelling value, I’m going, I’m still there. I haven’t turned off and said, ‘I can’t operate here’. I’m saying, ‘You know what, it’s very hard to, to create anything that can price that man out’. So that’s where I give the big tick to FRC but most people say, ‘Oh 90% market share, it hasn’t been successful’. Whereas I don’t feel that way. I really, really think they’ve got a nice balance between what’s good for them and what’s good for the consumer.” (Active)

“I think it is a good thing... or it is a double edged sword really. I would suspect we would see price reductions potentially but more likely the prices rise to reflect what a normal business would hope to make as reasonable profit from the customer. At the end of the day, the retailer is taking on all the risk.” (Inactive)

In terms of non-price based rivalry, inactive retailers described a number of ways in which they would start marketing and competing in the ACT. This included different types of products and superior customer service.

“And to encourage customers to switch to us, very hard without being cheaper, and our sort of approach is to then hang on to them with service obviously, without necessarily being cheaper all the time, but being competitive. But provide maybe better service than AGL does...I think the approach that we have that’s a bit unique, different to the others, is that we actually communicate with our customers by voice more frequently than larger companies do. And I think that’s appreciated by customers. We normally get our billing correct and accurate. We think our competitors have had issues in billing over the years. So they’re a couple of things that we do.” (Inactive)

“We certainly think our product offering is a very specific one designed around our [non-energy related products] ... We’re not necessarily planning to offer the vanilla standard three monthly billing, pay every three months type stuff. That’s not where our market, that’s not where our head is at. It’s not where our products at. ... And how that fits in with the existing regulations there are at the moment, I’m a little unclear, I haven’t spent

a lot of time looking at because we're just not ready to do that yet. And that would be another reason, if ... they were inflexible in the way that we could take payments and all those sorts of things from customers, then that's just another reason not to enter the market. [Company] for instance has, doesn't have offices anywhere. We like to do business by credit card and direct debit type circumstances. So we're looking to minimise, you know other payment options that are available to customers. ... You know, we don't want to offer pay over the counter. We have to, we want to charge fees to recoup our costs, all that sort of stuff... And we can do that within reason, in some states, but not in other states." (Inactive)

"We would consider it no different to a campaign than say a campaign to target marketing to Newcastle, or to Wollongong, or to some of the other regional centres where we target... rather than what we do in the bigger city markets where we have a team of doorknockers that would be out in different suburbs, you'd sort of more have a team that went there for a month period, or something like that. So you'd just attack it in a slightly different way from a channel strategy rather than a larger city perspective. So you'd do it more as a campaign basis, so you might see coming in with concentrated offers for a period of four to six weeks, and then maybe come back again in another three months, or four weeks, or something like that, rather than being out there all the time." (Inactive)

Most of the retailers interviewed indicated that keeping the prices as low as they are now could potentially be seen as beneficial for ACT residents and small businesses in the short term. However, they are of the opinion that some short-term pain would be better for consumers in the long run, so as to avoid a situation similar to that in Western Australia. A couple of interviewees explained that in that state, the electricity price was suppressed for quite some time, as long as ten years, and the consumers now have to catch up and be subjected to a dramatic price shock with increases of as much as 300%. A couple of retailers commented that this type of scenario may also result in reduced investment in new infrastructure.

"It's hard for regulators to get it right. And ... there's no doubt if that headroom is right, they'll get active, they'll all start, and no one's going to be making excessive profits for more than a couple of days. It literally takes days for companies like AGL, Origin, TRU, etcetera, to get out there and roll an offer into the market. They might adapt it or make new ones over a longer term, but everyone has got something that they can roll into the market within the pretty short space of time. So that's the whole point of the market is that they'll find that right price point." (Inactive)

"So it basically needs to be in the margin that you make after wholesale and retail. So if you don't increase it enough, I know I would be as a manager of a retail business, I'd be really cautious about going in that market. Whereas if it was to increase by 20% or 30%, I might say, 'I think they're serious about this, so I might go in there'. But my prices wouldn't need to increase. Sorry, I wouldn't need to pitch my prices at 20% or 30% higher than what I would today; I'd only need to probably go in at about 10%. And then it

would depend what Actew does because they're the real competitor, right? So what do they do? Do they go, do they take advantage of the new price cap and price it at 30% more? Or do they, because if they did that then I could come in 20% under them. What would they do? They would bring, they would trim their prices. So there you go. You've got the beginning of competition starting to happen. And then it'd be on for young and old and you'd drive prices back down again, 'cause then that will have a knock-on effect on the wholesale market and you've got true competition happening. And that's what's happening in Victoria. And you know, you just need, I guess whoever, because I'm not sure who it is that actually pulls the trigger on this at the end of the day, on price deregulation. That body should make the first move, make this step happen. And I, you know, I think it'd be good for all consumers in the ACT... It might be short-term pain for long-term gain, I think." (Inactive)

"So if you take regulation away in pricing you've got mainly one player, ActewAGL. Does that mean that AGL starts to ramp up the prices? Probably. But at the point in time where that price becomes more than reflective of the benefit that customers are getting, someone will jump in and start to take it away. Problem is at the moment there's not an opportunity to do that. So when the consumer group says they're getting a pretty good deal on the tariff cap, they probably are...and someone pays for it somewhere else along the line. Because they have to buy the power in the market, they have to do all those things. So it might look good to the consumers, but it will be coming out somewhere else...Power prices look really good to consumers in Western Australia, and they're about 40% under what they should be." (Inactive)

"WA provides another interesting case study where the generator was compelled to, I think it even put in its annual report 'set prices below cost' and it's now in a position where they've got to get themselves out of that hole ...[another colleague adds: they're getting like, 300% price increases]... Very substantial price increases is what you're seeing, because they have to catch up at some point and that's really not good for customers. And I mean it doesn't look good for the companies for a long time obviously." (Active)

"Competition keeps prices as low as they should be. If they're being artificially suppressed by regulatory decisions, competition will actually push prices up, because they'll start to reach cost reflectivity." (Active)

"Once that's occurred, then you won't be able to stop it. Competition will just set in. Real competition will set in and prices will, we'll all be competing against each other. That's what happens here in Victoria. And the issue is that someone's got to have the courage to allow that to happen in the first step. Now, if you only increase price caps by 10%, it might not be enough to stimulate real competition ... that has to be 10% margin, not network charges going up because we don't make any money on that. They're all pass-throughs. So it basically needs to be in the margin that you make after wholesale and retail. ... Whereas if it was to increase by 20% or 30%, I might say, 'I think they're

serious about this, so I might go in there', but my prices wouldn't need to increase."
(Inactive)

"Why [the regulated price] would be so low and whether or not it isn't, I say this with caution, but perhaps even artificially low, that if you did a long enough price projection you'd actually say, 'Well, no, no, no. We need to be on a steeper curve just to, you know'. Like it might be to do with the age of the infrastructure in Canberra or, you know. I don't know what it is but you just have to say that with the history of it in every other jurisdiction, pretty well, I think without exception in Australia every other jurisdiction. Like Western Australia has had severe price shocks, haven't they?" (Active)

Most of those interviewed expect that the retailers that do have existing customers will in turn take additional measures to ensure that their products remain attractive to customers in a non price regulated market.

"We've got a lot of retention strategies on the shelf ready to dust off, so we'd definitely be looking at some of those and looking at becoming more efficient where possible... Maybe picking out market segments a bit better and focusing on that. I think there would be more innovation and those sorts of things would happen I think. ... that the segments could be revealed and targeted and given more value." (Active)

"We are trying to change the market; I imagine that ActewAGL's focus has been sharpened. If you introduce competition, or introduce FRC into the marketplace, even if you're only got a couple of competitors kind of dabbling in and out, it will focus the incumbent's attention on 'we need to have the right products, we need to be sharp with our customer service', etcetera. So it will always create benefit." (Inactive)

Who is Responsible?

In terms of responsibilities for facilitating effective competition in the Territory's small consumer retail electricity market, the general consensus among the retailers interviewed is that the ACT Government is responsible, specifically the Energy Minister. Some also see a role for the ICRC and a number of retailers drew attention to the ICRC's activities in terms of calling for the removal of price regulation.

Longer term, a few participants observed that there is a role for the AEMC and the Australian Government to facilitate greater competition through the introduction of the National Energy Customer Framework and other initiatives such as smart meters and carbon pricing.

"Quick adoption of [National Energy Customer Framework] NECF. Minimisation of its regulatory overheads. Elimination of standing prices, regulated prices. All the things retailers want in the world." (Inactive)

National Energy Customer Framework

The National Energy Customer Framework (NECF) is regarded by the retailers interviewed as an important initiative because it is expected to result in efficiencies and cost savings for retailers due to the elimination of different regulations for each jurisdiction within the Australian energy market.

“With the National Energy Consumer Framework that should be rolling in over the next couple of years, but it’s been on the agenda for five, six plus years, anything that makes the way you deal with customers, such as advice of prices changes, or contract provisions, etcetera, any streamlining of those sorts of things make a huge difference in the costs of entry. And it wouldn’t be any different for any of our major competitors.”
(Inactive)

“In every state we’re trying to get some consistency across the states with the National Energy Consumer Framework, because different solar feed in tariffs, different white label, white certificate things.” (Inactive)

Most of the inactive retailers interviewed mentioned the NECF as a potential future catalyst and added incentive for them to commence marketing activities in the ACT, as it means that they would not have to implement different processes and procedures (including staff training and customer service scripting) to comply with regulations that are unique to the ACT. They also indicated that the savings that will be realised through reduced regulatory compliance and administrative costs will help to improve their margins.

A few of the retailers interviewed pointed out that there are concerns among retailers generally about individual jurisdictions that might seek exemptions for their area, thus eroding the power of the framework.

“The regulatory hurdles associated with all of the different states and all the different foibles, as I like to call them, makes entry in to each market difficult. Things like the NECF being implemented into each state for both fuels will be really helpful in that regard... Its aim is to have one set of rules basically for every state, for all states, for both fuels... Very keen to see things like the NECF adopted nationally, and with as little interference at a state level as we can manage... The first thing that’s got to happen is the adoption of the NECF, and then we’ve got to have, the federal approach has to try to ensure that the meddling by the states and the retail market is minimalised ... Concessions and price regulation aside, I know this is part of that decision [when to be in the ACT].” (Inactive)

“So if the ACT, for example, wanted to introduce, you know, a special space on the bill to advertise a certain thing or promote something they could do that, and I think that’s of

concern to retailers going forward that are trying to have a nationally consistent framework to operate in.” (Active)

Importantly, the implementation of the NECF is really only seen by the retailers interviewed as an incentive to become active in the market in the case that price regulation is removed. This is because although there are costs associated with complying with the ACT electricity market regulations, retailers generally describe this as a minor issue relative to the broader issue of the regulated electricity price being too low to enable the margins necessary to justify entry into market, particularly in light of the high wholesale costs.

Smart Meters

All retailers interviewed are aware that smart meters are eventually going to be introduced, although only one participant mentioned that there is a trial currently underway in the ACT. Participants did not spontaneously raise smart meters as an issue in relation to competition within the ACT. When prompted, the overwhelming response was that without removing price regulation, it would be pointless to introduce smart meters, as the whole idea is for them to provide a price signal to the end user.

“I think it’ll make pricing more cost reflective, and I think it’ll make customers more aware of what they’re doing with their energy, and therefore more, perhaps a bit more price sensitive and more interested in looking around and changing their behaviour. It’s about awareness; increasing awareness. I think it almost makes administration both more difficult, and actually some of the traditional issues go away with quarterly readings and access issues and all that sort of stuff. But we’re adding a whole raft of new ones around time of year pricing and data, and all that sort of stuff.” (Inactive)

“Because otherwise tariffs can’t be set in an innovative way. We made this point many years ago to the government [in Victoria] that in an interval meter world, is the government still going to try and impose regulated prices? And if they are, how are they going to do that in a way that still lets the price signal go through to the consumer to ultimately try and curb usage at certain times (which is why the government wants to put smart meters in, in the first place)? So if you’ve got a price capped market, you then basically could nullify the advantages of what you’re trying to get with a smart meter if the pricing is not getting the price signal. So if the person feels no pain by using a bunch of energy on a hot day when they, at the time when they don’t want everyone to turn their air cons on, then, and once again if we’re in the private market competing with a capped price, why would someone go to our product that could give them potentially a higher rate at high usage times, versus going to the comfort of a government set rate that won’t hurt them as much? Even though we may give them more benefit in the longer run in the off-peaks, the consumer may say, ‘Well, why would I?’.” (Inactive)

There is an expectation among most of the participants in the research that smart meters will eventually influence consumer behaviours, provided the right pricing structure is in place. This is expected particularly in combination with the anticipated rises in electricity prices over the coming years. While some felt that it might not necessarily change customer behaviours in terms of energy use, they had more of a sense that it would make it easier for customers to switch retailers – and that if there are suitable alternatives in the marketplace (i.e. better deals), then it should help to boost switching.

“I think it’s a positive thing but whether it genuinely changes, and this is my personal opinion, changes people’s behaviour is another. We do have a smart metering pilot going on at the moment. I’ve got one of those units at my house. Interesting to see what it does but has it changed my behaviours? Probably not. I think at the end of the day it’s creature comforts – you know people want to stay warm when they want to stay warm and if it’s cold, they’ll turn the heater on, but I think it’s a really good education and awareness and I think when we’ve got the right pricing in the market, people will look into smart metering and see where they can cut costs as electricity bills become more expensive.” (Active)

“I think it makes switching faster. That’s one of the things that plagues the industry is slow switch timeframes for next reads and stuff like that, and costs. So it brings those costs down a lot.” (Inactive)

“The customer is still going to need a proposition that says this is worthwhile. But certainly if part of that proposition is switching is easy, well it will be.” (Active)

Environmental Issues and Climate Change

Although not a key consideration for retailers at present in relation to competition, environmental issues are expected to become increasingly important for the electricity sector in general. This covers water and resource availability (the physical effects of climate change on infrastructure for example), and waste management including emissions and other pollutants.

“I think this whole environment space is going to be interesting. I know we’ve talked about that ... where it takes the energy market. I think there’ll be fundamental shifts in the energy market in three to five years.” (Active)

While all active retailers offer green electricity services as an option to their customers, a few of the retailers interviewed were of the opinion that consumers see a price discount offer as more attractive, especially in difficult financial times.

“I just don’t see people leap, the whole green energy thing and the CPRS has dissipated as fast as it sort of commenced. Loyalty to green energy is low, it’s a bit like buying furs, they’ll buy them in good times and not in bad type thing.” (Active)

“New South Wales you have a mandatory obligation to offer 10% green as your first product offering anyway. [Colleague 2:] But people never take it up when you offering a discount as well. [Colleague 1:] There’s a small minority of the group that do, but more often than not they’re more interested in the discount rather than taking the green offer.” (Inactive)

A couple of the inactive retailers indicated that they see their renewable energy products as a competitive advantage.

“We’d love to be selling our green products in Canberra. We actually sell our green products to a whole of lot of politicians we know in their home bases outside Canberra. So we’d love to be there. But we will only go if we can make some money.” (Inactive)

The retailers interviewed expressed uncertainty about the Australian Government’s intentions to introduce a possible emissions trading scheme or other possible carbon pricing mechanisms in light of the Government’s recent decision to postpone any decisions until 2013. In turn they expressed uncertainty about the ways in which such a scheme may impact on the way retailers and consumers behave. Such uncertainty acts indirectly as a barrier to investment decisions, but is not seen as unique to the ACT market. For example, some mention was made of how wholesalers are reluctant to enter into long terms contracts due uncertainty around the Carbon Pollution Reduction Scheme (CPRS).

“I think it’s just the whole uncertainty in terms of going out; we just don’t know what it’s going to cost. I think ... they talk a lot about energy efficiency and peak demand and there is going to be new infrastructure that’s going to be required to meet peak demand. But, again, that’s not a retail – it’s more a generation and a distribution issue ... like for the whole market, a new generation ... don’t know whether that’s going to be coal, wind, solar – what it’s going to be – what technology it’s going to be.” (Active)

“... all this renewable stuff – that can evaporate tomorrow if the government wakes up one morning and says ah, okay, we’ll scrap the renewable energy target scheme or we’ll scrap this ... those things have such a huge impact on the way the energy market behaves.” (Active)

“Every state doing their own environmental schemes and efficiency schemes [for example]. So if a state, like in ACT, created some funny rules or regulations that may have an impact on your desire to go in there.” (Inactive)

“The CPRS is an issue because it’s an unknown.” (Inactive)

“And that’s the issue with CPRS, and smart meters, and even just the way they estimate wholesale costs and they model forward prices for two years, and they’re trying to do it in an efficient format so that there is no I guess over recovery, because the risk is just as

high as over or under recovery - or the opportunity to get it out of whack when you're trying to estimate forward prices, there's a risk that the retailers will over recover, which is not what the regulators are there to make happen. Then if they under recover then retailers don't want to play in the markets, so they disappear. So it's not an easy position for regulators to be in either, and as we said earlier there's no doubt if anyone is making good profit it will disappear pretty quickly in Australia because there's plenty of competitors." (Inactive)

A few retailers expressed minor concerns about potential inconsistencies in environmental regulations across states from an added administrative cost perspective.

"We've got different environmental schemes we have to comply with within each jurisdiction, and each of those is slightly different in the way that it operates....So it makes it more difficult to manage. But again it's just part of what you do as a retailer. So your basic answer is no, but it does have complicating factors." (Inactive)

Ten Years' Time

Without removing price regulation, most of the retailers interviewed feel that the market would essentially stay the same. In contrast, if price regulation is removed, or at least set at a suitable (i.e. higher) level, most expressed a strong sense that the market will become highly competitive and more dynamic, with more retailers of different sizes and with different offerings actively competing in the market. That is, similar to what has been observed in Victoria to date.

[If price regulation is removed:] *"The market will be just as competitive, and as exciting, and as full of innovative products as any other state would be...Which is what we would do. If we can do something in Victoria that we think works for the customers, if we have the conditions that we can do it in the ACT we would do it. Why wouldn't we offer that same product?" (Inactive)*

One participant had quite a different view on what the market may look like in 10 years' time.

"Well in ten years time I don't think it would look like Victoria, because I think Victoria is not going to look like this in ten years time. There would be two or three major players nationally, with some small players around, probably no mid-sized players like us, unfortunately; small players around the edges, and consumers would be making choice based on brand awareness, I think you'll see direct sales have dissipated, people will be sick of it. Everything from cars to vacuum cleaners to encyclopaedias is sold door to door when it first hits the market. The fact that energy is still being sold door to door ten years after the commencement of competition actually amazes me, I can't believe it. I think it shows a complete lack of imagination on the part of all of us." (Active)

Conclusions

Most of the retailers interviewed are hopeful of a decision by the ACT Government's Energy Minister to remove price regulation in the ACT. They feel that this, along with a number of other measures being implemented either by the ACT or the Australian Government – for example, the National Energy Customer Framework and potentially some form of carbon pricing, will facilitate greater levels of effective competition in future. Most retailers interviewed have indicated that they would respond to such decisions by actively stepping up their activities to gain a share in what is a small but nonetheless attractive market.

If price deregulation does not happen, the retailers interviewed think that there is likely to be little change from the current levels of competition. While retailers have indicated that keeping the prices low as they are now could potentially be seen as beneficial for ACT residents and small businesses in the short term, it could result in a much larger price shock in the future when the time does come for the retail price to become cost reflective.

Considering a range of broader contextual issues including the transition to a low carbon economy, climate change, energy market and even tax reforms, many of the retailers interviewed expect to see some significant potential changes in the ACT electricity market in coming years.

Appendix 1 – In-Depth Interview Guide



AEMC Retailer Interviews

Question Line – 31 March 2010

Following is the question line for use with electricity retailers in the ACT. Note:

- *This is a guide only and questions will not always be asked word for word – rather, the interviewer will cover all these questions in a one hour period.*
- *The times in brackets indicate the approximate weighting of each section of the interview.*
- *The interviewer will adapt questions to different retailer situations as required.*
- *The questions with an asterisk (*) indicate that the retailer may choose to come back to GA Research with that information in subsequent days.*

1. Introduction to Interview

(2 mins)

- As you are aware, the AEMC has commissioned GA Research to conduct interviews with retailers in the ACT to inform its review into the effectiveness of competition in the electricity retail market in the ACT, covering small consumers across domestic and small business customers (under 160MWh pa).
- GA Research is an independent market and social research firm that is a member of the Association of Market and Social Research Organisations (AMRSO). We are bound by strict privacy rules so you can be assured that what you say in this interview will be treated as confidential and shared only with the AEMC.
 - Transcripts of these interviews will be provided to the AEMC.
 - GA Research will write a report on the findings that will be published by the AEMC. However, in this report, individual company's comments will be treated as unattributable.
- Do I have your permission to record this interview?
- Please note that if there is anything that you think of and wish to convey after the interview, you are very welcome to contact me.

2. Company Background

(5 mins)

- a. Can you tell me about your role in the organisation, including how long you have been with the company?
- b. Please give me an overview of your organisation's activity in the ACT.
If the following issues are not covered then probe as necessary:
 - i. When were you licensed? When did you start operations?
 - ii. What market share does your company have?*
 - iii. What electricity products and services do you offer small customers in the ACT? *(ask for full list of products/services including whether for domestic or small business customers*)*
- c. What other markets does your company operate in?
 - i. What are the similarities between how you operate in the ACT in comparison with other states, if any?
 - ii. What are the differences, if any? Explore perceptions of why similarities/differences exist.

3. Offers and Marketing Activities

(10 mins)

- a. What is your marketing strategy in the ACT?
 - i. What channels do you use? If necessary, prompt on: door to door, telesales, direct mail, general advertising, special offers and incentives, customer retention/loyalty activities, information provision (for example around energy usage/conservation, retail prices) etc
 - ii. What marketing materials do you use?* *(ask for copies)*
 - iii. Which of your products and services are most popular? What aspects are customers attracted to? Why?
 - iv. Who are your target markets?*
 - Do you have a preferred customer profile? What is this profile? Are you able to accurately target this group? Has customer targeting changed over time?
 - Are there any segments of the market that you avoid targeting? What are your reasons for this?
 - v. What sort of market research do you do? *(ask for copies or excerpts*)*
- b. What marketing strategies and channels do you find work best in the ACT? What doesn't work in the ACT?

- c. How does your marketing strategy compare to the other players in the ACT market? Have you seen other players engaging in any marketing activities that you would consider to be inappropriate?
- d. Financials
 - i. What is your overall marketing budget?
 - ii. What is your average customer acquisition cost and your average customer retention cost in the ACT market?*
 - iii. Is your company's profit margin in the ACT to expectation and acceptable? Explore reasons. What are you able to share in this regard [e.g. actual profit margin]?*
- e. Are you considering introducing any new products or services into the ACT market?
 - i. If not, have you considered introducing any in the past? Under what circumstances would you consider it?
- f. Do you expect your marketing in the ACT will change in the future? Why? Why not?

4. Knowledge and Perceptions of the ACT Electricity Market (7 mins)

- a. Can you broadly describe the nature of the ACT electricity market?
 - i. Who are the key players? Who are the other operators that you are aware of? How are they different or similar to your organisation? How are their products and services different from yours?
 - ii. What do you believe to be the market share of other players in the market?
- b. How has the market changed since full retail contestability was introduced in 2003? If not mentioned, prompt on: market structure, mix of operators, market conditions and the regulatory framework.
 - i. Have these changes been positive or negative for your organisation? Explore reasons.
 - ii. For each change/issue: Do you think this has been positive or negative in terms of encouraging competitiveness in the ACT electricity market? Explore reasons.

5. Competitiveness, Retailer Rivalry and Customer Switching (15 mins)

- a. On a scale of 0 to 10 where 0 means not at all competitive and 10 means extremely competitive, how would you rate the ACT market in terms of competitiveness for small consumers?
 - i. What makes you say this?
 - ii. How has this changed over time?
- b. On what basis are retailers competing, in your opinion? What evidence have you seen of this?
 - i. To what extent is there price rivalry?
 - Probe for market offers for residential customers, small business customers and tariff design including discounts and rebates
 - ii. What about non-price rivalry?
 - If not mentioned, prompt on green energy products, use of in-kind incentives, customer service, multi-utility(bundled services) etc
- c. Can you comment on switching trends in the ACT over the past few years?
 - i. What do you believe are the current levels of switching amongst small consumers in the ACT? A great deal, a lot, a moderate amount, a little, none at all
 - ii. Are there any differences in switching amongst domestic versus small business customers?
- d. What do you believe are the main drivers behind consumers switching retailers in the ACT?
 - i. What are the actual tipping points?
 - ii. Are there any differences between domestic, small business customers, and more specific customer segments? Explore differences and reasons.
- e. What do you believe are the main barriers to electricity customers switching in the ACT?
 - i. Are there any differences between domestic and small business customers, and more specific customer segments? Explore differences and reasons.
- f. Do you know roughly how many customers are on negotiated market contracts in the market?
 - i. If necessary say: This fell to approximately 30,000 by 30 June 2008 indicating that a number of customers have taken the opportunity to return to the regulated retail price.
 - ii. What do you think of this? Why do you think this has occurred?

- g. Do you think any consumer types have less access to competitive electricity offers than others? Explore who and why – e.g. those with special needs, domestic vs small business consumers, pensioners, those from a non-English speaking or different cultural background, low income etc.
 - i. If necessary prompt on market structure, regulation, nature of customers' own circumstance.

6. Catalysts and Barriers to Market Entry, Expansion or Exit (20 mins)

- a. For your company, what are/were the main reasons or catalysts for you to enter the ACT small consumer market for retail electricity?
- b. What do you think they are for other companies entering or about to enter the ACT market?

(For a and b - write down main catalysts and get respondent to rank the most important, second most important etc. Also get a sense of relative importance)

- c. *(If not operating)* For your company, what are the main barriers to entry?
 - i. Are you considering entry? Under what conditions?
 - ii. If necessary: Assuming that your company is perfectly hedged against wholesale market risk and climate change policies have been enacted, what are the main barriers to entry?
- d. *(If operating)* What do you think the barriers are for other companies entering the ACT market? Did your company experience any before commencing operations?

(For c and d - write down main barriers and get respondent to rank the most important second most important etc. Also get a sense of relative importance.)

- e. Economies of scale:
 - i. How many customers are required to make entry viable?
 - ii. Importance of being able to offer bundled products? Perceptions of bundled products in the ACT market?
 - iii. Importance of dual fuel offers
- f. Thinking now about electricity companies that are already operating in the ACT:
 - i. What have you observed in terms of electricity retail companies expanding or contracting in the market?
 - ii. What do you see as the main drivers, triggers or reasons for your company to expand your operations in the ACT?

- iii. What do you think the drivers are for other companies to expand in the ACT market?
 - iv. What are the main barriers to expansion for your company? What do you think the barriers are for other electricity companies?
- g. Why do you think some companies may choose to exit the ACT market?
 - i. What are the costs and issues associated with exiting?
 - ii. What are your company's plans in terms of the ACT market? Are you looking to stay / start operating / expand / change strategy / exit? Explore reasons and timelines.
 - h. Generally, would you say conditions of entry or expansion in the ACT have improved or worsened over time? How / in what way? Why?

In this section, ask questions listed above and listen to unprompted responses before probing on the extent to which the following are issues:

- ACT market characteristics – the location, weather (including impacts on door to door marketing), size of market, type of people etc
- Uncertainty about future issues including:
 - CPRS and other environmental legislation
 - climate change/global warming
 - possible introduction of smart meters
- Advantages and disadvantages of incumbency – ActewAGL Retail
- Access to network and distribution infrastructure and distributor requirements – the fact that distribution is controlled by ActewAGL
- Costs and risk management
 - Prudential requirements (incl AEMO) and credit support arrangements
 - Ability to manage wholesale risks
 - Are fixed market entry costs an issue?
 - Licensing costs
 - Customer acquisition and retention costs
 - Marketing costs
 - IT and customer service operations - outsourcing
 - Exit costs
- Regulatory compliance
 - What are the roles of:
 - the regulated retail price
 - electricity specific concessions
 - Inconsistent regulations and energy efficiency schemes in states and territories
 - Impacts

7. Future Directions for the ACT Electricity Market

(10 mins)

- a. In terms of the future, do you think that any new players are likely to enter the ACT electricity retail market for small consumers? What sort of companies do you think are likely to enter and succeed? Briefly explore.
- b. And do you foresee any players exiting the market? Briefly explore reasons.
- c. Do you believe the ACT electricity retail market needs to be more competitive, specifically for small customers? Why?
 - If yes: what changes do you believe need to take place to make the ACT electricity market more competitive?
 - If no: what would you like to see happen in terms of the process or way in which retail price regulation is removed?
- d. What organisations do you believe are ultimately responsible for facilitating competitiveness?
- e. What do you think the ACT electricity market will look like 10 years from now:
 - i. If no changes are made?
 - ii. If the changes you suggested are made?
 - How do you think the retail sector would change?
 - How do you think your own organisation would change?
- f. What issues do you expect may impact on competition in the future?

8. Wrap-up

(2 mins)

- a. Is there anything else you would like to add or that you think we should be aware of?
- b. As I said if there is anything that you think of later on and would like to have this included in your responses, please get in touch with me.
- c. Thank you very much for your time.