TRUenergy Australia Pty Ltd
ABN 96 071 611 017
Level 33, 385 Bourke Street
Melbourne Victoria 3000

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The Australian Energy Market Commission
PO Box H166
Australia Square
NSW 1215

submissions@aemc.gov.au

Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia - Issues Paper

Thank you for the opportunity to comment upon the Commission's *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia - Issues Paper*.

The Commission's First Final Report on retail competition in Victoria found the Victorian retail energy market to be effectively competitive. Whilst the conclusion was based on a comprehensive review of a range of potential indicators, the key defining characteristics of the market were identified as:

- Strong rivalry between retailers
- Retailers offering customers discounted tariffs with a range of non-price incentives
- Customers demonstrating a high willingness to switch retailers
- Substantial new entry into energy retailing

In all these respects the South Australia market mirrors the Victorian experience. Customers have been exposed to aggressive marketing campaigns by both incumbent and new entrant retailers, with the latter capturing significant market share in an environment of high customer churn. Competition has generally involved the same retailers, offering the same products, marketed via the same techniques, and eliciting the same customer response in South Australia as in Victoria. International comparative analysis shows South Australia to be the third most competitive electricity market in the world, behind only Victoria and Great Britain.[1]

The most recent review of the effectiveness of retail competition in the South Australian retail energy market was completed by NERA Economic Consulting in a report for the Essential Services Commission of South Australia (ESCOSA) in June 2007. NERA concluded that the electricity market was effectively competitive, and that the Adelaide gas market was well established and likely to be effective. The reservations regarding gas were due to structural features of the market.

[1] First Data Utilities (2007), *World Energy Market Rankings*, July 2007.

Consistent with the views of NERA, TRUenergy does have concerns with some structural features of the South Australian gas market which impede retail competition:

- Access from SEA Gas is not possible to customers on Le Fevre peninsula, and problematic to commercial/industrial customers in Adelaide's northern suburbs in the absence of additional gate stations.
- Pipeline access to customers on lateral pipelines to the north of Adelaide (and SESA pipeline) requires separate negotiations with the incumbent retailer. Retail products that are based upon interruptible haulage are not commercially viable for large customer sites and potentially non-compliant with regulatory instruments for mass market customers.
- Commercial risks for new entrant retailers arising from potential exposure to swing gas, which are not recognised in ESCOSA retail price determinations.

Whilst notable, the first two issues, canvassed at length in the NERA report, do not have a material impact on competition among mass market customers. However, the final point raises our general concern with the level of retail gas prices set by ESCOSA, which recently have not fully recognised the costs and risks of operating in the South Australia gas market. A direct consequence has been a decline in the transfer rate relative to other comparable markets, as shown in the table below.

Market	**Average Annualised Monthly Transfer Rate Jul07-Mar08**
Victoria gas	21.0%
South Australia electricity	20.3%
South Australia gas	13.1%

This reiterates our constant theme in the Commission's competition reviews; the greatest threat to retail competition is the retention of price regulation. As noted by the Commission in the Victorian reports, the retention of price regulation poses an asymmetrical risk to the industry, exacerbated by volatile wholesale markets. If regulated prices are set too high, the presence of effective competition will ensure that any excess margins available to the incumbent retailer in the short-term will be rapidly eroded. However, if prices are set too low, the ability of new entrant retailers to compete will be restrained, jeopardising future investment signals and threatening the long-term security of supply.

Responses to the questions raised by the Commission are provided in the appendix.

Please contact me on (03) 8628 1122 if you require additional information.

Yours sincerely,

Graeme Hamilton
Regulatory Manager

Appendix – Responses to Issues for Comment

	Issue	Response
1	Have the structural conditions for energy retailing in South Australia supported or hindered the development of effective competition? Are these structures likely to support or impede further improvements in competition in the future?	The structural conditions have supported the development of effective competition, as evidenced by the entry of new retailers, their expanding customer base, and the declining market share of incumbents. Issues specific to the gas market have been raised in the NERA report and in our submission above.
2	Are there barriers to entry that impact on the development of effective competition? Have these barriers dissuaded prospective energy retailers from entering or can they be overcome? Are these barriers likely to persist or abate?	As above
3	Are there barriers to expansion or exit that impact on the development of effective competition? Have these barriers dissuaded prospective energy retailers from entering or can they be overcome? Are these barriers likely to persist or abate?	As above
4	Are there unique or specific features of the South Australian electricity or gas retailing environments that may support or impede the development of competition?	Only in respect to the gas market, as raised in the NERA report and in our submission above.
5	To what extent do retailers compete with each other to acquire new customers and retain existing customers? What does the current level of rivalry between retailers indicate about energy retailing in South Australia?	The extent of rivalry in the market is appropriately measured by the level of customer transfer activity. On this dimension the South Australian electricity market is among the most competitive retail energy markets in the world. The relative decline of transfer rates in the gas market reflect ESCOSA's pricing decisions not fully recognising the costs and risks of operating in that market.
6	Has retail price regulation encouraged or impeded tariff innovation, product differentiation and service competition?	Price regulation and the restrictions upon varying the minimum terms and conditions of the Retail Code impede innovation, differentiation and service competition. This is demonstrated by the dominance in the market of price discounted products, often with a similar tariff structure to the regulated rate, and restricted service level differentiation across these products.

7	On what basis, and to what extent, might retailers be expected to compete in the future?	Product differentiation and innovation will continue to be restrained until price regulation is removed, and the minimum terms and conditions of customer contracts have greater flexibility to reflect consumer preferences. The greatest threat to retail competition is the maintenance of price regulation and the ongoing potential for regulated tariffs to be set below market-based levels.
8	What does the nature and extent of marketing activity indicate about the level of competition? What do the types of marketing activities undertaken by retailers indicate about the level of competition?	Marketing strategies are developed in accordance with each respective retailer's business model, with the market determining the success of each approach. As a low-involvement commodity, energy sales are overwhelmingly retailer-driven, with high transfer rates reflecting intense marketing activity.
9	Is there evidence of retailers engaging in mis-selling and other anti-competitive marketing practices?	This is a compliance issue not relevant to the retention of price regulation. Nevertheless, as noted in the NERA study, the South Australian energy market has an excellent market conduct record.
10	Are retailers able to recover their efficient costs at current standing and market offer contract tariffs? Are future expected profit margins likely to be sufficient so as to encourage new entry and increase competition or insufficient such that new entry is deterred?	The ability of retailers to recover their efficient costs, and thus the future competitiveness of the retail energy market, remains problematic within a price regulated framework. The rationale for establishing the competitive market is that regulators are incapable of replicating efficient market outcomes. ESCOSA's gas pricing decisions, in particular, represent an immediate threat to retail competition in the gas market.
11	What effect, if any, does retailer exposure to fluctuations in wholesale electricity and gas price have on retailers' ability to offer competitive product and service offerings?	It is the role of retailers in the competitive market to manage wholesale risk, and retailers compete on this basis. However, the ability of regulators to accurately forecast, in some cases years in advance, movements in wholesale markets when setting retail prices is problematic in the extreme. The regulatory risk this imposes on retailers diminishes the benefits of competition that would otherwise flow to consumers.
12	What motivates customers to switch from a standing offer to a market contract or to switch retailer? For those customers who are not willing to participate in the competitive market, what underpins their decision to remain on a standing offer?	There are many potential motivations for accepting a market offer. The key factor is that offers are available, and are being accepted. It is a misrepresentation to suggest that all customers remaining on a standard offer are "not willing to participate in the competitive market". Instead their behaviour may be a rational choice, reflecting satisfaction with the incumbent and the product, as well as the relatively low cost of energy as a proportion of total household expenditure.

13	Do retailers actively compete to offer the products, services, prices and other conditions of supply which are most attractive to customers? Do retailers respond to changes in consumer taste by offering new, different or better products in a timely manner?	Regulated tariffs and the inflexibility of the Retail Code restrict the dimensions upon which retailers compete. Nevertheless, the growth of green energy products is evidence that developments in consumer preferences are reflected in product offerings, to the extent the regulatory framework allows.
14	Are customers able to access information that is easy to understand, relevant and up to date, and enables competing offers to be compared? Do customers rely on this information when deciding whether to switch? If not, why not?	The level of customer transfer activity confirms a very high level of confidence among consumers regarding their energy purchase decisions.
15	Are there classes of customers who are unable to access the benefits of competition? If so, what factors contribute to the difficulties experienced by these customers?	Beyond the regional gas issue, the market is characterised by generic offers available to all consumers, based on tariff-type, not any social or consumption-level dimension.
16	What steps, if any, do retailers take to assist customers experiencing difficulties in participating in the competitive market? Are these initiatives effective in assisting these customers?	Customer “difficulties” generally relate to bill payment rather than participation in the competitive market. Whilst payment difficulties reflect broader financial issues, given that energy is only a small proportion of total household expenditure, retailers provide multi-layered assistance through customer hardship programs.