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28 February 2014

Mr Chris Spangaro
Senior Director
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

Envestra

Dear Chris,

Approach Paper - 2014 Retail Competition Review (RPR0002)

Envestra is Australia's leading natural gas distributor with around 1.2 million customers located in South Australia, Victoria, Queensland, New South Wales and the Northern Territory. This submission sets out information on the extent of retailer participation in those areas served by Envestra's networks, including in both metropolitan and regional areas.

Figures 1 to 4 show changes in the host (or incumbent) retailer market shares across those metropolitan and regional areas served by our gas distribution networks (noting that Envestra only owns regional networks in New South Wales). This information shows that retailer participation/competition:

- is far stronger in metropolitan areas than in regional areas; and
- is stronger in Victoria relative to the other states.

With regard to the first point, the host retailer in regional South Australia and Queensland has a 99% market share, which situation has persisted following both the introduction of full retail contestability and the deregulation of retail prices in those markets. In New South Wales, the host retailer has a 95% share of the regional market.

With regard to the second point, the relatively low market share of the host retailer in Victoria is most likely a reflection of the decision by the Victorian government to establish three large host retailers when the businesses were privatised in the late 1990s. This had the impact of creating strong levels of retailer participation/competition before markets were deregulated.

Figure 1: South Australian Host Retailer Market Share, June 2003 to December 2013

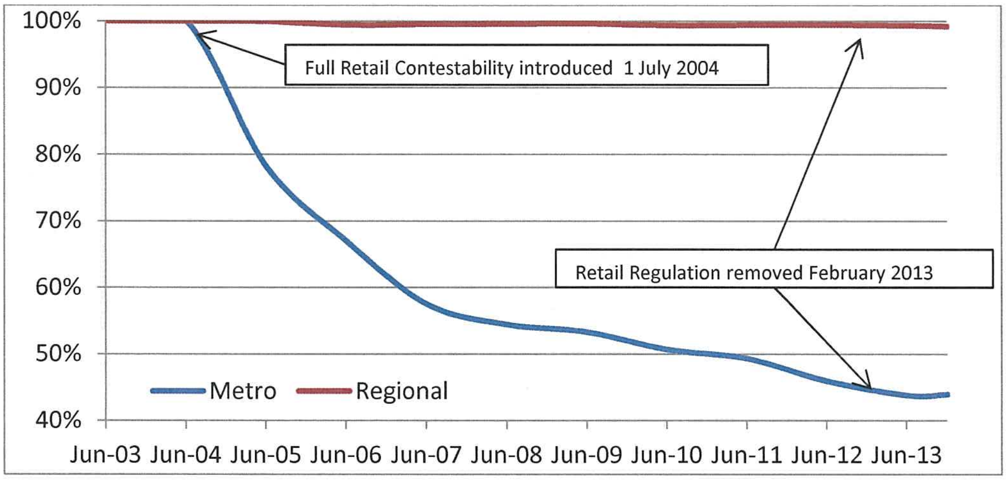


Figure 2: Queensland Host Retailer Market Share, June 2003 to December 2013

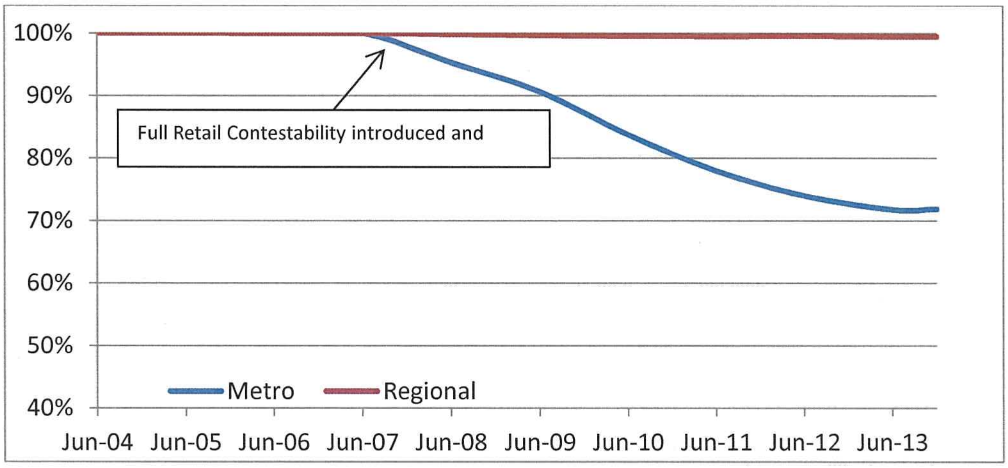


Figure 3: Victoria Host Retailer Market Share, June 2006 to December 2013

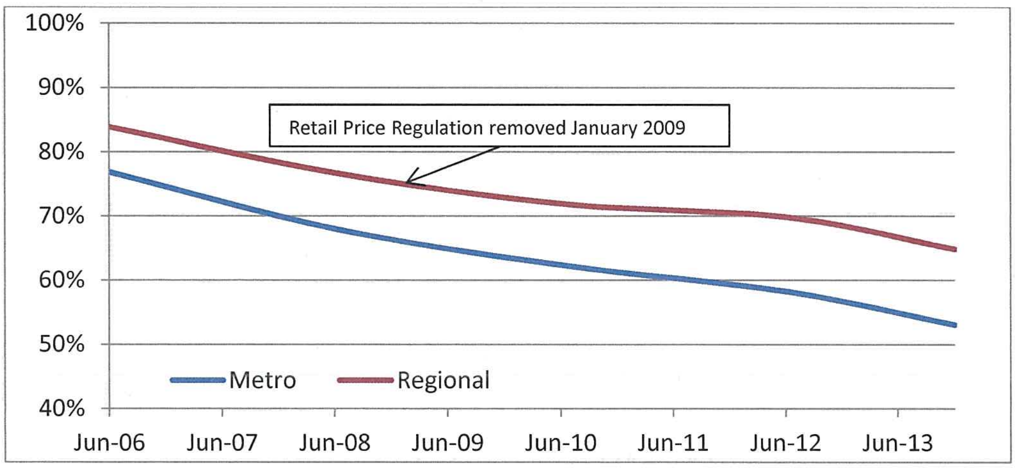
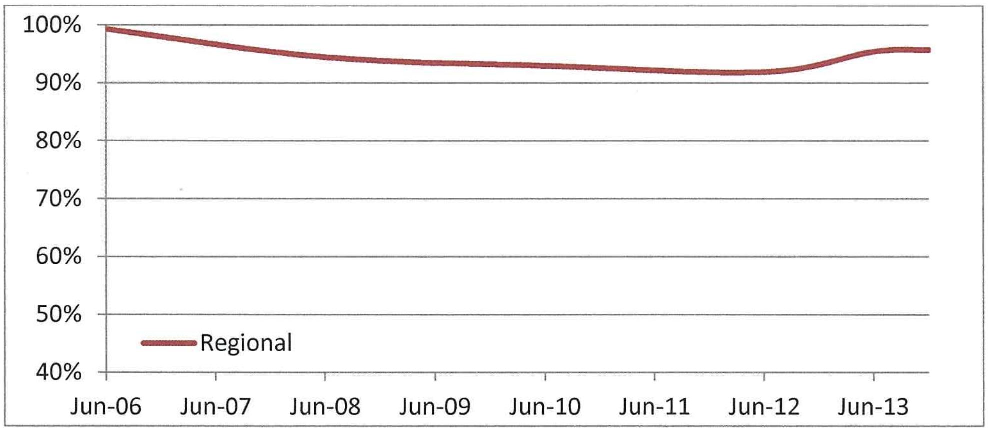


Figure 4: New South Wales Host Retailer Market Share, June 2006 to December 2013



The lower retailer participation in regional areas is likely to reflect the high costs/risks relative to the potential benefits of supplying those smaller markets. These costs, many of which are fixed regardless of market share, include procuring small volumes of gas supply from producers, entering into transmission and distribution haulage contracts, IT system costs and marketing costs to attract new customers.

Envestra considers that the above information suggests that any analysis of retail markets should be conducted at a reasonable level of granularity. This will ensure, for example, that a lack of competition in a certain area is made transparent (and not hidden through its inclusion in a larger area where competition might be more prevalent).

Envestra therefore considers that the AEMC should, at a minimum, differentiate between metropolitan and regional areas in its review. Individual regional markets should also be separately identified, particularly for the initial retail competition reviews, to determine whether any issues exist within a particular jurisdiction. This will ensure any related policy decisions/implications are properly informed.

Attached to this letter are further responses to certain questions raised by the AEMC Approach Paper. Please feel free to contact either myself (08 8418 1129) or Peter Bucki (08 8418 1112) if you would like to discuss this matter further.

Yours sincerely

Craig de Laine
Group Manager – Regulation

APPENDIX 1: Envestra Response to Specific Questions

A Questions for stakeholder submissions

This section does not respond to all questions set out in Attachment A to the AEMC Approach Paper, noting that certain questions are aimed directly at retailers and customer groups. Envestra has sought only to address questions where it has relevant data and/or experience gained in operating its gas distribution networks in South Australia, Victoria, New South Wales, Queensland and the Northern Territory.

Market definition

1. Is there evidence to support alternative market definitions to those that we are proposing to use for the review? We plan to base our analysis on separate markets for electricity and gas in each NEM region (ie two markets per region), except for Queensland where South East Queensland will be treated as a separate geographic market to the rest of Queensland.

Envestra Response:

The information provided in our submission supports defining markets more precisely, particularly for the purposes of the initial retail competition reviews undertaken by the AEMC. This will ensure, for example, that a lack of competition in a certain area is made transparent and not hidden through its inclusion in a larger area where competition might be more prevalent.

For example, the Wagga Wagga retail gas market is supplied by two retailers, one of whom has a 97% share of the market (this situation is similar to the Albury gas market). This lack of competition would not however be made transparent if the market is combined with other markets where competition is more prevalent (which would occur if the NSW gas market was defined as a single market).

Envestra therefore considers that the AEMC needs to, at a minimum, differentiate between metropolitan and regional areas for each gas and electricity market. Individual regional markets should also be separately identified to determine whether any issues exist within a particular jurisdiction. This will ensure any related policy decisions/implications are properly informed.

Customer activity in the market

2. Are small customers able to access energy related information that is easy to understand, relevant and up to date, that supports their decision-making process to choose an energy offer?

Envestra Response:

Our review of retailer websites and the AER "Energy Made Easy" website has found that no retail gas contract offers are available for certain regional areas (such as Wagga Wagga), despite retailers selling gas to customers in those regions. This would likely lead to customers incorrectly forming the view that alternate gas offers are not available (or at worst, that gas is not available in that region).

6. Are there any barriers preventing customers from switching energy plans within their current retailer or offered by an alternative retailer?

Envestra Response:

As noted in response to question 2, a lack of information regarding the availability of alternate gas market offers presents a considerable barrier to customers switching energy plans and/or retailer. In some cases, this might reflect that retailers are not particularly interested in selling gas where the costs/risks are likely to outweigh any potential benefit (as is the case with certain small regional markets).

Barriers to entry, exit or expansion

7. Are there any current or expected barriers to entry, exit or expansion that impact on the development of effective competition in small customer electricity and natural gas retailing?

Envestra Response:

As noted earlier, our information shows that there are relatively low levels of retail competition in the smaller regional gas markets. We have formed the view that this reflects a reluctance by retailers to supply these markets due to the high costs/risk relative to the potential benefits.

EnergyAustralia in its submission[1] to the National Competition Council (NCC) review into revocation of coverage of the Wagga Wagga gas distribution network highlighted this issue. EnergyAustralia identified a large and diverse range of factors that need to be addressed by a retailer before entering a new gas market, which matters include:

1. Registration and certification with the Australian Energy Market Operator;
2. Obtaining transmission haulage to the network receipt points;
3. Obtaining distribution system haulage;
4. Procuring suitable gas supply from producers;
5. Procuring/managing gas supply hedges to offset risks in the wholesale gas market;

1 EnergyAustralia *Supplementary Response to Envestra's Application for Revocation of Coverage - Wagga Wagga Gas Distribution System* June 2013 p1.

6. Establishing the business to business protocols including new connections and other service orders;
7. Building suitable tariffs and tariff structures to manage distribution network tariffs and retail risks;
8. Building processes and protocols to manage network billing;
9. Establishing new connection processes;
10. Ensuring customer contracts and terms address regulatory obligations and distribution processes; and
11. Educating operational staff on the market issues of each network including emergency management

Envestra considers that significant expenditure would also need to be incurred by retailers on marketing in order to attract new customers, especially for a new retailer that is not active in the relevant gas sales market and needed to develop a brand presence to attract new customers.

What is clear from the EnergyAustralia submission is that there are a large number of activities, costs and risks that need to be incurred before entering a market. These costs are largely fixed regardless of the number of customers that a retailer might attract. In some cases, retailers might simply not be able to procure small quantities of gas and/or pipeline capacity to supply the market.

Retailers therefore need to take on significant cost and risk to enter new retail markets with little potential benefit from that entry in the case of the smaller regional networks.

Envestra notes that retailer submissions to the recent AEMC review into the effectiveness of retail competition in NSW raised the need to enter into a distribution supply contract as a barrier to entering a gas market.[2] This would appear to be a negligible barrier given the other activities/costs listed by EnergyAustralia in their submission to the NCC. This argument is also counter to the:

- relatively high levels of competition in metropolitan areas (where a distribution supply contract is also required);
- significant disparity in competition between metropolitan and regional areas, including in South Australia and Queensland where a single distribution supply contract applies across each state; and
- incentive on gas distributors to facilitate new market entry and competitive retail markets in order to support improved network growth/utilisation.

These facts suggest that barriers other than the need to enter into a distribution supply contract are preventing participation in certain regional markets.

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[2] AEMC Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales – Draft Report 23 May 2013, p 75.

Retailer outcomes

20. Are energy retailers to small customers able to recover their efficient costs and an appropriate return at current standing (or regulated) offer contract tariffs or at current market offer contract tariffs?

Envestra Response:

NSW is the only jurisdiction in which Envestra operates where retail gas price regulation currently applies. Envestra is aware of arguments made by certain retailers that regulated retail prices are insufficient to recover efficient costs, which issue is often sited as a reason explaining low levels of retail competition in certain areas.

Envestra considers it vital, where it continues to be appropriate for retail prices to be regulated, that prices are set at levels that are supportive of retailer entry/participation. Envestra is not however able to advise whether retail prices are insufficient as we are not privy to any information put forward by retailers in support of such claims.[3]

Envestra supports the AEMC review into the adequacy of regulated retail prices given the important role they play in facilitating the transition to retail price deregulation. Envestra considers that this review should evaluate retailer costs across a diverse range of markets, including electricity and gas markets, metropolitan and regional markets and competitive and non-competitive markets.

Importantly, any review into the adequacy of regulated retail tariffs should be based on a detailed assessment of the benchmark components of the regulated tariffs (i.e. allowed retail margin, cost per customer and so on) against an assessment of efficient costs. This will provide greater certainty to both existing and potential retailers in a particular market over the adequacy of regulated retail tariffs.

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[3] Envestra does however note that, despite claims that regulated retail prices are too low, a retailer operating in one of our regional networks decided against increasing their price by the near 20% allowed for by the regulator.