



EnergyAustralia

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Dear Commissioners

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

EnergyAustralia welcomes the opportunity to make a submission to the Australian Energy Market Commission's Issues Paper for its review of retail competition in the New South Wales electricity and natural gas small customer market.

EnergyAustralia is one of Australia's largest energy companies, providing gas and electricity to over 2.7 million household and business customers. EnergyAustralia owns and operates a multi-billion dollar portfolio of energy generation and storage facilities across Australia including coal, gas and wind assets with control of over 5,600 MW of generation in the National Electricity Market.

Since early 2011, we have been the Standard Retailer in the greater Sydney region for electricity and have been retailing to NSW electricity and gas customers from the introduction of the contestable market on a combination of both market and regulated contracts in NSW.

To support and underwrite this retail customer base we've built generation in NSW (the 435 MW gas fired Tallawarra power station) and bought the trading rights to the Mt Piper and Wallerawang power stations under the Delta West Gentrader bundle.

Importance of this review

Retail price deregulation is a long term reform goal of the National Electricity Market (NEM) and one that EnergyAustralia supports. A deregulated market will facilitate a wider range of products and services for customers and keep downward pressure on prices through increased levels of competition. It will also remove a significant regulatory risk and encourage new entrants and existing participants to make long term investments in the market.

Progress towards price deregulation has been incremental across the NEM to date. However, the energy reform focus of 2012's Council of Australian Governments and the Standing Council on Energy and Resources meetings has generated momentum. This was affirmed by South Australia's announcement in late 2012 and subsequent deregulation of prices in February 2013 and the market's response in terms of competitive offerings.

The AEMC's current NSW review is an opportunity to build on this momentum. In our view the present market conditions in NSW support deregulation. The market is displaying vigorous competition and

customers are being offered with increasingly innovative products, choice, and additional services such as EnergyAustralia's MyEnergyReport.

In EnergyAustralia's recent public submission to the Independent Pricing and Regulatory Tribunal's regulated price determination, our preliminary view was that the average regulatory price increase would be around CPI over the next three years. This would be a welcome period of relative price stability after a number of years of significant regulated price rises, in the order of 10 to 20 per cent.

We strongly support the AEMC's review process and have attached the following responses to the questions in the Issues Paper regarding the state of competition. As the AEMC moves to the second stage of its review later this year, we look forward to engaging on the questions of pathways to deregulation and accompanying measures.

If you would like more information, please do not hesitate to contact me on 03 8628 1359 or temay.rigzin@energyaustralia.com.au

Regards,

Signed for email

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Responses to Issues Paper questions
<p>Question 1 Market definition (a) To what extent can other fuels or products be substituted for the supply of electricity or natural gas to small customers in NSW's electricity and natural gas retail markets (including the extent to which they are substitutes for each other)?</p>
<p>A number of substitutes are available for electricity and gas supply for residential and small business.</p> <p>In terms of fuel switching, electricity and gas are substitutes for each other for a number of small customer applications e.g. heating, cooling and cooking.</p> <p>There is also a significant increase in the number of customers substituting away from centralised supply through generating power for their own consumption via small scale solar PV. These have, and continue to be, supported by regulatory incentive mechanisms at the Federal and State level, as well as ongoing buy back arrangements for power fed back to the grid.</p> <p>Small customers also substitute capital for energy input through the use of more energy efficient products. There has been growing awareness and information provision about energy efficiency options, included regulatory mechanisms. Retailers also provide information to customers about energy efficiency opportunities.</p>
<p>Question 2 Market definition (a) Are there barriers to single-fuel energy retailers (i.e. suppliers of either electricity or natural gas only) supplying both electricity and natural gas to small customers in NSW's electricity and natural gas retail markets? (b) Do energy retailers of both fuels (i.e. suppliers of both electricity and natural gas) enjoy cost or other advantages over single-fuel energy retailers?</p>
<p>Assuming necessary industry infrastructure is in place, there are generally not barriers to dual fuel supply. Over time more companies are moving towards offering dual fuel products or additional benefits for bringing over their second fuel to a single retailer.</p> <p>There are some commercial benefits in being a "one stop shop", such as in terms of cost to acquire. However, many retailers still have a large single fuel customer base and customers shop around for the best deal in each fuel.</p>
<p>Question 3 Market definition (a) Are there different costs to serve electricity small customers, and/or natural gas small customers, at different energy consumption levels in NSW's electricity and natural gas retail markets? (b) Are there barriers to energy retailers supplying electricity, and/or natural gas, to small customers at different energy consumption levels in NSW's electricity and natural gas retail markets?</p>
<p>Theoretically there would be different costs to serve different types of customer groups however these customers groups are defined. Though, it is generally not practical or useful to collect and breakdown costs for customers using different amounts of energy for any significant degree of granularity. Variable cost to serve is, in most cases, more closely aligned to customer behaviour than energy consumption (e.g contact centre calls, bill payment method etc).</p> <p>In general, it is more important for a retailer to ensure that the fixed and variable parts of the retail electricity and gas tariffs are set in a cost reflective manner – i.e. that fixed retail or network costs are not recovered through the usage components of the retail</p>

tariff.

Question 4 Market definition

(a) Are there different costs of supplying electricity, and/or natural gas, to small customers located in different geographical areas or distribution networks of NSW? For example, the cost(s) of supplying energy to small customers residing in rural or remote areas of NSW compared to the cost(s) of supplying energy to small customers residing in urban areas.

Electricity and gas costs do vary regionally. The key differences associated with supplying to customers in different geographic locations are twofold: the network tariffs associated with each distributor (applies to both electricity and gas); and the loss of electricity associated with its distribution to customers, with higher loss factors associated with customers living further from the point of supply.

Network losses are taken into account via the annual publication of loss factors. Some costs to serve for remote customers may be higher such as meter reading and other services that require site visits. However the decision by a retailer to charge differentiated costs for these services is offset by the administrative costs of establishing and recovering differentiated costs, as well as potential brand damage. These issues are taken into account by retailers and we see no major differences to the retailer marketing activity to customers in these areas.

Where these costs are set by a distributor or other third party they can be a straight pass through by a retailer. The decision by an upstream supplier to differentiate costs would also include the same considerations that a retailer would make – generally the complexity of a highly granular pricing structure is cost prohibitive.

Question 5 Market definition

(a) What other characteristics of NSW's small customer electricity and natural gas retail markets should the AEMC take into consideration when defining the market for the NSW Review?

Covered in earlier questions.

Question 6 Market structure

(a) Have the structural conditions for small customer electricity and natural gas retailing in different geographical areas or distribution networks of NSW supported or hindered the development of effective competition?

(b) Are the structural conditions referred to in (a) likely to support or impede improvements in competition in the future?

Since the establishment of full retail contestability, and in particular over the last 18-24 months, competitive activity in the New South Wales retail market has developed strongly. It is now characterised by aggressive price and service based competition both between the large Tier 1 energy companies and with a number of smaller market entrants.

Following the NSW retail privatisation process in 2011, there has been an intensification of competitive activity, from large retailers and new entrants, including increasing price discounting, significant marketing spend to build awareness and encourage switching behaviour, and activities to retain existing customer bases and maintain new customer acquisitions.

However, relative to Victoria where pricing is fully deregulated, there has not been the same level of competitive breadth and intensity, and less innovation, due to the continuation of retail price regulation reducing the attractiveness of the market and increasing the risk, particularly for smaller, new market entrants.

Question 7 Market structure

(a) Are there barriers to entry that impact on the development of effective competition in small customer electricity and natural gas retailing in different geographical areas or distribution networks of NSW?

(b) Have the barriers to entry referred to in (a) dissuaded prospective energy retailers from entering NSW's small customer electricity and natural gas retail markets, or can they be overcome?

(c) Are the barriers to entry referred to in (a) likely to persist or abate in the future?

The main barrier to entry in the NSW market arises from the regulatory environment. Regulation is important and necessary for the efficient functioning of the sector. However, where regulation is inconsistent with other jurisdictions or introduces significant risk, it can reduce the attractiveness of entry into a market or the expansion/innovation of activities. In particular, price regulation is a barrier to entry and expansion where margins are low or negative or there is a risk of this outcome.

One limited area where there are barriers to entry is in the Far West region of the Country Energy supply area, where we do not offer any tariffs to small customers. One reason for this is the high number of tariffs that can apply to a relatively small number of customers, which increases the likelihood that quoting or billing errors will be made with pricing and is costly to support. This issue can be overcome through the rationalisation of tariffs in this supply area.

In addition, barriers to entry may also arise in some NSW gas distribution areas, with the risk that retailers will not want to enter unless they are confident that margins on the regulated tariff are reasonable and consistent in all years.

Question 8 Market structure

(a) Are there barriers to expansion, or exit, that impact on the development of effective competition in small customer electricity and natural gas retailing in different geographical areas or distribution networks of NSW?

(b) Have the barriers to expansion, or exit, referred to in (a) dissuaded prospective energy retailers from entering NSW's small customer electricity and natural gas retail markets, or can they be overcome?

(c) Are the barriers to expansion, or exit, referred to in (a) likely to persist or abate in the future?

As per question 7. An additional barrier to exit is reputational impacts that arise from an exit.

Question 9 Market structure

(a) Are there unique or specific features of the small customer electricity and natural gas retailing environment in different geographical areas or distribution networks of NSW that support, or impede, the development of competition? For example, energy retailers offering small customers "multi utility" products and services (e.g. across energy, water and telecommunications industries) or "dual fuel" products and services (i.e. in electricity and natural gas)

As noted in question 7, there are specific issues in parts of the Country Energy electricity network. Retailers have a greater incentive to enter the market where they can offer both fuels, so some retailers may be discouraged if price regulation affects margins for one fuel even though margins may be sufficient for the other fuel.

Question 10 Market conduct

(a) To what extent do energy retailers compete with each other to acquire new, and retain existing, small customers in NSW's electricity and natural gas retail markets?

(b) What sort of product and/or service improvements have retailers delivered to small

customers in NSW's electricity and natural gas retail markets?

There is a high degree of competitive rivalry in the NSW market, with strong price and non-price based competition between large and small energy retailers. The level of electricity switching in NSW has been increasing at a steady rate since early 2008. In under five years, this rate has risen from around 7% to 19%, making NSW one of the most active switching markets in the world. While switching statistics are not the sole metric to measure competition, research shows that globally, markets with high switching rates can experience greater levels of service and benefit from better product differentiation.

Regarding gas markets, we agree with the analysis by IPART in its review of regulated retail prices and charges for gas 2013-16 that shows that competition in the NSW gas market has increased since the last review. Fewer customers remain on regulated tariffs and significant discounts to the regulated tariff are available and are readily accessible to customers via IPART's *myenergyoffers* site. As a second tier retailer in the NSW retail gas market we have seen a net increase in our customer numbers each year since the last review which shows that switching activity, a key indicator of effective competition, is strong and sustainable.

Due to the competitive nature of the industry, retailers have looked to develop new products to meet the needs of customers and improve service (for instances, through upgraded billing and customer management IT systems).

As an illustration, EnergyAustralia offers the regulated rate and discount products (with varying discounts and contract lengths), a Rate Fix product (that allows customers to lock in their rates at today's regulated rate for two years), time of use options, together with a range of features, for example:

- Dual fuel products – for those customers wanting both gas and electricity
- Acquisition offers - eg magazine subscriptions, gift cards, rebates
- Bill Smoothing functionality (SmarterPay)
- A green energy add on
- Solar feed in tariffs

EnergyAustralia has also developed MyEnergyReport, which provides tailored information on customers' energy use and allows progress tracking and provides ideas on energy efficiency.

Question 11 Market conduct

(a) Has retail price regulation of electricity and natural gas encouraged, or impeded, tariff innovation in NSW's small customer electricity and natural gas retail markets?

(b) Has retail price regulation of electricity and natural gas encouraged, or impeded, product differentiation in NSW's small customer electricity and natural gas retail markets?

(c) Has retail price regulation of electricity and natural gas encouraged, or impeded, service competition in NSW's small customer electricity and natural gas retail markets?

In general, a market with price regulation introduces a key regulatory risk to retailers. Even if regulated margins are reasonable in any one year, there is always the risk that a regulator may set the tariff too low in the next year. This risk alone will stifle innovation and investment even where margins are otherwise adequate.

In the NSW retail market, the regulated price has not encouraged tariff innovation, differentiation or service improvements. Where the regulated rate has been set too low to recover efficient costs, it has restricted tariff innovation because it has constrained the ability to discount. More broadly, the risk that the regulated pricing regimes brings to the

market stifles innovation, and hence differentiation.

Question 12 Market conduct

- (a) On what basis, and to what extent, might energy retailers be expected to compete in NSW's small customer electricity and natural gas retail markets in the future?
- (b) Describe the availability and take up of time of use tariffs in NSW's small customer electricity and natural gas retail markets?
- (c) What impact may time of use tariffs have on competition in NSW's small customer electricity and natural gas retail markets in the future?

In our view, competition will continue to be vigorous in NSW, provided there is a supportive regulatory environment. This refers to both price regulation where it remains and non-price regulation. For example, proposals to limit the ability of retailers to charge early termination fees can stifle the availability of products and discounts.

An indication of the response of the market to price deregulation can be seen from South Australia, where in December the South Australian Government announced that it would deregulate electricity prices from February 2013. Over the following week, there was an increase in competitive activity, with deep discounts and large sign up bonuses offered.

EnergyAustralia offers a time of use tariff to both residential and small business customers. Due to the number of type 5 meters in the Ausgrid distribution area, EnergyAustralia has the greatest number of TOU tariff customers. Over time, the move to time of use tariffs is likely to increase as competitive capability and consumer understanding of time of use tariffs increases. As this happens, time of use tariffs will open a new field of innovation and differentiation for customers to take advantage of.

Question 13 Market conduct

- (a) What does the nature, and extent, of marketing activity indicate about the level of competition in NSW's small customer electricity and natural gas retail markets?
- (b) What do the types of marketing activities undertaken by energy retailers indicate about the level of competition in NSW's small customer electricity and natural gas retail markets?

There is a high level of marketing activity, as would be expected with a strong level of competition. Different types of marketing are pursued, including online, door to door, kiosks, telephone marketing. The industry has responded to feedback about different types of marketing e.g. the establishment of door knocking codes. Our experience indicates that the increasing range of the types of marketing channels suggests that the market is very competitive and that retailers wishing to obtain or maintain a presence in NSW need to be proactive in developing new sales approaches.

Question 14 Market conduct

- (a) What types of marketing practices, or business behaviours, have small customers experienced in NSW's small customer electricity and natural gas retail markets?

In addition to the marketing channels led by retailers listed in question 13, customers have also experienced third party marketing, such as independently developed third party switching websites and One Big Switch. One Big Switch was a particularly high profile example of customer participation in the competitive retail market which raised the profile of the competitive market. There is also an increase in the influence of digital market through online.

Question 15 Market conduct

- (a) What effect, if any, does energy retailer exposure to fluctuations in wholesale electricity and natural gas prices have on energy retailers' abilities to offer competitive product and service offerings to small customers in NSW's electricity and natural gas retail markets?

The NEM wholesale market is highly volatile. Prudent retailers seek to hedge this volatility via different ways (vertical integration, exchange traded futures, bilateral swaps, long term power purchase agreements). Hedging has a cost. Where wholesale cost allowances in regulated prices are insufficient and do not account for this volatility and the cost of hedging, then this can affect retailers' ability to offer competitive prices. Unexpected step changes in wholesale costs or associated components (green costs, carbon costs) can put additional commercial pressures on retailers, especially where these are not reflected in regulated rates, and may lead to variability in marketing behaviour in some years.

Question 16 Market conduct

- (a) What motivates small customers to switch from a standing (or regulated) offer contract to a market offer contract in NSW's electricity and natural gas retail markets?
- (b) What motivates small customers to switch energy retailers in NSW's electricity and natural gas retail markets?
- (c) With respect to electricity feed-in tariffs, have small customers experienced any difficulties in terms of switching retailer due to a leasing agreement for their solar panels?

Customers are becoming increasingly aware of the benefits of NSW competitive retail industry and willing to shop around. Customers switch looking for the offers that suit their needs and preferences e.g. large discounts, fixed rate products, plans with more flexibility.

In our experience, the majority of customers with solar panels have not experienced issues switching to us from another retailer.

Question 17 Market conduct

- (a) Are small customers in NSW's electricity and natural gas retail markets able to access energy related information that is easy to understand, relevant and up to date?
- (b) Are small customers in NSW's electricity and natural gas retail markets able to access energy related information that enables competing energy offers from energy retailers to be compared?
- (c) To what extent do small customers in NSW's electricity and natural gas retail markets rely on the energy related information referred to in (a) and (b) when deciding whether to switch energy retailers?
- (d) What information are small customers presented with by their energy supplier at, or near, expiry of their existing energy supply contract? What action(s) must small customers undertake to ensure a continuation of energy supply?

Information and understanding supports participation in the market. A range of price comparison websites are available from private providers and government supported sites, including IPART's *myenergyoffers*. EnergyAustralia provides pricing fact sheets for all commonly available offers on our own site. There is also an increase in the publicly available information on energy efficiency, e.g. in the general media. As noted above, EnergyAustralia has also recently developed its MyEnergyReport which provides free, personalised information on energy use and energy efficiency tips.

We present relevant information on our electricity and gas offers through various channels including over the phone, online and face to face direct sales. In our experience the majority of customers will take this information into account before making a final decision.

Our NSW customers receiving a written letter 28 days prior to the expiry of their current benefit, which outlines their new market offer. Customers are not required to action this and they are automatically migrated onto the new offer. For customers who want to re-

examine their options they are encouraged to call us directly prior to the expiry of their current benefit term.

Question 18 Market performance

- (a) Are energy retailers to small customers in NSW's electricity and natural gas retail markets able to recover their efficient costs at current standing (or regulated) offer contract tariffs?
- (b) Are energy retailers to small customers in NSW's electricity and natural gas retail markets able to recover their efficient costs at current market offer contract tariffs?
- (c) Are future expected profit margins for energy retailers in NSW's small customer electricity and natural gas retail markets likely to be sufficient to encourage new market entry and increase competition, or will new market entry be deterred?

As the experience with price regulation in Australia over the last decade has shown, price regulation is an incredibly complex exercise in the dynamic electricity market. In particular, the risks are asymmetric: if regulated prices are set too high, they can be competed down. In contrast, if they are set too low, the cost is borne by the energy industry. Provided the regulated price sufficiently reflects the costs and risks of retailing, we would expect competition to continue to be strong and new entry incentivised. EnergyAustralia is currently engaging closely with IPART in the determination process to set the next regulated price period.

Question 19 Market performance

- (a) To what extent do energy retailers actively compete to offer the products, services, prices and other conditions of energy supply which are most attractive to small customers in NSW's electricity and natural gas retail markets? For example, retailers offering small customers tailored advice on ways to lower their household energy usage.
- (b) To what extent do energy retailers respond to changes in small customer preferences in NSW's electricity and natural gas retail markets?
- (c) Do energy retailers currently issue NSW small customers a single bill for their electricity and natural gas usage?

Retailers compete strongly to offer the products, services and prices that are valued by customers. This can be seen in the range of products that are developed that have different features to suit the preferences of different customers. As noted in question 10, EnergyAustralia offers a range of product types and features to meet the preferences of customers.

In response to customer demand for more information, we have also developed a free product called MyEnergyReport. This provides tailored advice to customers to lower their household energy usage through tips, online engagement, and meaningful comparisons of their home's energy usage with similar households in the neighbourhood (e.g. heating/cooling type, house size).

In NSW we have less than 10K customers who receive a single bill for their electricity and gas usage. However, we haven't seen considerable customer demand for this feature.

Question 20 Market performance

- (a) To what extent do energy retailers in different geographical areas or distribution networks of NSW compete with each other in terms of price to acquire new, and retain existing, small customers in NSW's electricity and natural gas retail markets?

We compete across the state, although as noted in question 7, we do not offer any tariffs to small customers in the Far West region of the Country Energy electricity supply area.

Question 21 Other considerations

- (a) Are there classes of small customers who are unable to access the benefits of

competition in NSW's electricity and natural gas retail markets?

(b) What factors contribute to the difficulties experienced by the classes of small customers referred to in (a)?

Competition brings a number of benefits, including choice of retailers, choice of product, choice of bill payment options, greater information and downward price pressure. To our knowledge, these benefits are generally available to all small customers in NSW.

Question 22 Other considerations

What initiatives do energy retailers undertake to assist small customers experiencing difficulties in participating in NSW's electricity and natural gas retail markets?

(b) How effective are the energy retailer initiatives referred to in (a) in assisting small customers?

EnergyAustralia has a hardship policy in place to support customers having difficulties with meeting their bills. There are also a range of regulatory requirements setting out the approach with customer experiencing difficulties. We support targeted measures to assist low income and vulnerable customers in gaining access to required pricing and services that can help them.

EnergyAustralia's activities include: advice and practical steps to help customers manage their usage and implement energy efficiency steps, tailored payment arrangements; regular reviews; partnering with community welfare organisations; referring to financial counsellors; and referrals to government initiatives such as the Home Energy Saver Program in NSW and the Federal Home Energy Saver Scheme.

We also support a review of NSW Government concessions and rebates and will participate in the Energy Affordability Roundtable (proposed by the NSW Ombudsman and NSW Government) to assist with the identification and development of initiatives that will make a meaningful difference to customers who are struggling to pay for energy.

Question 23 Identifying a path to removing retail price regulation:

(a) Are the approaches in past reviews useful as a basis for NSW? Should the path to deregulation be gradual or should price regulation be removed for all customers at the same time?

(b) What are the benefits of a gradual approach? If a gradual approach is preferred, what increments i.e. how many stages should there be and what should be the applicable level of eligible consumption? Over what time frame? Should businesses be deregulated first?

(c) What types of small customers fall within the current 160MWh electricity threshold and the 1TJ natural gas threshold? What are the annual consumption ranges for residential customers and small businesses customers?

(d) What information should be provided to customers to establish awareness of price deregulation? What customer protections are required?

As the NSW market is contestable and there is a high level of competition, in our view the conditions are in place for the removal of regulation for all consumption levels. We therefore consider that price regulation should be completely removed as soon as practical.

As the AEMC moves to the second stage of its review later this year, we look forward to engaging on the questions of pathways to deregulation and accompanying measures. However, as an initial comment, if price regulation were removed in two or more steps, we would prefer that the customer groups are based on customer type rather than usage brackets. Our tariffs are defined by customer type (residential, business, peak anytime, time-of-use, etc.). Removing price regulation for business customers first and then residential customers would make it operationally easier for most retailers and would be

less confusing for customers. This was the path followed when Victoria removed price regulation and moved to price monitoring.

Small customers below the 160MWh and 1TJ threshold typically fall into two categories - residential households and small to medium business customers. With regards to annual consumption ranges, customers can fall anywhere from close to zero usage through the maximum thresholds indicated by AEMC. However, we typically see residential customers falling into the range of 2-10MWh and 10-40GJ, with small to medium business running the full spectrum, given the very diverse nature of the customers within this segment.

We support a customer awareness campaign that set out the changes and informed customers of the ability to switch such as through IPART's *myenergyoffers* site. A range of customer protections are set out through the NECF and the existing consumer law. In our view, no additional protections would be required upon introducing price deregulation.

Question 24 Improving the effectiveness of competition

(a) Where effective competition does not exist, in the context of improving competition, should similar options to addressing full deregulation of retail prices apply? If yes, which one? If no, what options should apply?

(b) Are there any other areas that should be considered for improvement if competition is found to be ineffective? If so, what options should apply to address these particular areas?

In our view, effective competition exists.