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Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

AEMC project number RPR0001

Dear Sir/Madam

Review of competition in retail electricity and natural gas markets in New South Wales – Issues Paper

AGL Energy (**AGL**) welcomes the opportunity to make a submission to the Commission in response to its Issues Paper on its review of competition in retail electricity and natural gas markets in New South Wales (**Issues Paper**).

As one of the largest energy retailers in Australia, AGL is well placed to comment on issues in the electricity and gas industries. AGL operates nationally across the energy supply chain and has investments in coal-fired, gas-fired, renewable and embedded electricity generation. AGL is Australia's largest private owner, operator and developer of renewable generation in Australia, and is also a significant retailer of energy with more than 3 million electricity and gas customers.

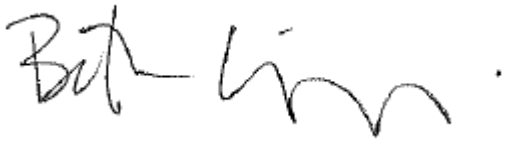
AGL welcomes the Commission's review into competition in respect of New South Wales gas and electricity retailing. We have, in **Attachment 1** to this letter, provided detailed responses to most of the Commission's specific questions in its Issues Paper. AGL has sought to demonstrate the high degree of competition faced by electricity and gas retailers in New South Wales.

It is an opportune time in which to remove the regulation of retail gas and electricity prices in New South Wales, and replace it with a regime of regulatory price monitoring as occurs in Victoria and South Australia. Deregulating retail energy prices would be a positive step for all participants in the State's energy industry. It is in the long term interests of retailers who would have the flexibility to be able to develop innovative products that meet customer demands at genuinely cost-reflective prices. It would be in the long term interests of customers, who would have access to product offerings from a larger number of retailers than would be the case if sub-economic regulatory price setting led to the departure of retailers from the market or the contraction of competition amongst existing retailers who would face no incentive to innovate and provide competitive product offerings. It would in fact be highly beneficial to the State's energy industry as a whole, and would go a long way towards creating an environment which promotes efficient investment in generation, the existence of energy security, optimal utilisation of infrastructure, and the continued development of the current state of competition that exists, while ensuring minimal unnecessary administrative burden.

Competition has strengthened in Victoria since the deregulation of retail energy prices in 2009, with retailers offering a diverse range of products, and high customer churn rates indicating customers' willingness and ability to move between retailers to carefully select energy plans that are most appropriate to their needs. AGL considers that the benefits from deregulation in Victoria that have flowed through to consumers and the industry alike demonstrate the importance of moving along this path in New South Wales.

AGL would be happy to provide further information to the Commission should this be helpful. Please contact Anita George at ageorge@agl.com.au or on (03) 8633 7212 if you have any questions in relation to AGL's position on these issues.

Yours sincerely,



Beth Griggs
Head of Energy Markets Regulation

Attachment 1

Response to Commission's specific questions as set out in its Issues Paper

Market definition

There is a high level of competition in respect of the retailing of electricity and gas in New South Wales, and customers are provided with a great deal of choice in terms of energy offers available to them. Therefore, even if the Commission conducts its review on the basis of New South Wales markets for retailing gas and electricity, it should be satisfied of the existence of effective competition amongst energy retailers.

Question 2

Barriers to single-fuel retailers retailing both electricity and gas are low, and in fact currently five active energy retailers in New South Wales are dual fuel retailers (AGL, Origin Energy, EnergyAustralia, Australian Power & Gas and Lumo Energy).

The same billing systems can be used to bill both electricity and gas customers, hence some cost advantages exist for dual fuel retailers.

Not all premises in New South Wales have gas connections, therefore generally it is a commercially attractive proposition for gas retailers in New South Wales to sell electricity as well. However it is not necessary to enter the market as a dual fuel retailer, and numerous single-fuel electricity retailers exist in New South Wales.

Question 3

Whilst costs incurred by a retailer such as labour, systems and overheads are likely to be shared across customers with different usage levels, some retail cost elements are linked to the level of usage. Costs related to bad and doubtful debt are generally higher for electricity customers because the value of an average electricity bill is higher than an average gas bill, and therefore the cost for default is higher.

There are no significant barriers to a retailer of electricity or gas supplying different energy consumption levels across the small customer category. It is generally common for new entrants to start retailing to small business customers and then to move to selling to residential customers. The metering technology and billing systems are the same across residential and small business customers, hence minimising any difficulties in selling energy across different consumption levels.

Question 4

Costs for retailing gas and electricity vary across geographical areas and distribution networks in New South Wales. This is particularly relevant for retailing electricity and gas to small customers residing in rural or remote areas of New South Wales. For example, electricity and gas transmission and distribution costs borne by retailers (and passed through to customers) vary significantly across the different distribution areas within the State. However, the vast majority of customers live in the major metropolitan areas where costs do not vary as significantly.

Question 5

Retailing electricity in New South Wales

AGL considers that analysing the nature and extent of competition in respect of retailing electricity in New South Wales needs to be viewed from a broader perspective than simply New South Wales, and should instead be considered in the context of retailing electricity in the National Electricity Market (**NEM**) as a whole.

Retail competition in the NEM has undergone constant evolution since its introduction, and continues to develop. Full retail contestability has been introduced throughout the NEM, and is entrenched and effective in all jurisdictions where it has been introduced.

The progress of competition is also seen, for example, in:

1. The expansion of retailers into multiple regions;

2. The integrated nature of the NEM, resulting in factors such as:

    a. A move towards NEM-wide systems for settlement, churn, metering and billing; and

    b. A move towards NEM-wide regulatory regimes.

Conditions for effective retail competition in the NEM are now entrenched. The key factors underpinning effective retail competition include:

1. An absence of substantial basic product differentiation (not including energy efficiency and other complementary products) because electricity is a fungible commodity.

2. The design of the NEM as a compulsory energy-only market, as a consequence of which there are no material barriers to retailers acquiring electricity for resupply.

3. No material barriers to access to risk management products including electricity derivatives; and

4. A large number of retailers operating either standalone or as vertically integrated businesses across the NEM.

In the light of the considerations above, particularly the advanced and continuing development of a NEM-wide retail market, it is appropriate for the Commission to consider the retailing of electricity in New South Wales as constituting part of a NEM-wide market for the retailing of electricity.

However, given the high level of competition amongst electricity retailers in New South Wales, the Commission should be satisfied of the existence of effective competition even if it defines the market as narrowly as a New South Wales market. Accordingly, if the Commission is satisfied that effective competition exists in an artificially narrow market, then it follows that market participants would be subject to even greater competitive constraint from a more appropriately-defined, broader market.

Retailing gas in New South Wales

AGL considers that the relevant market in which the Commission should consider that gas retailers in New South Wales compete is the market for the sale of retail gas on the East Coast, comprising South East Queensland, New South Wales, the ACT, Victoria and South Australia. Support for this proposition includes:

1. The overlap between retailers in those areas;
2. The introduction and development of full retail contestability;
3. Moves towards national regulatory regimes; and
4. Increasing interconnection in Eastern Australia, especially with the commissioning of the QSN Link.

AGL does not support the consideration of gas retailing in New South Wales in a market defined as narrowly as a New South Wales market. However, as set out throughout this submission, there is workable competition for the sale of gas in New South Wales. Accordingly, even in the context of such a narrow market definition, the Commission should be satisfied that effective competition exists for the retailing of gas in New South Wales.

Market structure

Question 6

The current market structure in which electricity and gas is retailed to residential and small business customers in New South Wales is highly competitive.

The level of electricity customer churn in New South Wales has been increasing at a steady rate since early 2008, and is now at around 19%, making New South Wales electricity one of the most active switching markets in the world.

While gas churn levels are lower than for electricity, they have been trending upwards in recent years, from around 9% in September 2011 to around 14% in December 2012[1].

These figures demonstrate the relative ease and willingness with which customers move between electricity and gas retailers to find a product which best suits their needs.

There is vigorous and effective competition between electricity and gas retailers in New South Wales. Currently Origin Energy, AGL, EnergyAustralia, Lumo Energy and Australian Power & Gas compete heavily to offer both gas and electricity products. They also compete strongly with Dodo Power & Gas, Momentum Energy, and Red Energy for the sale of electricity.

Churn figures are lower in rural areas than metropolitan areas. This can be at least partially explained by there being less targeted marketing activities in these areas given higher retailer costs associated with covering greater geographic distances, and a lower (although markedly increasing) level of awareness by rural consumers as to their ability to switch electricity retailers. However, the trend is towards increasing churn in rural areas, and in any case these regional areas comprise a small proportion, by customer number, of customers within New South Wales.

Much more significant is the commercial and policy uncertainty caused by regulatory intervention in retailers' pricing decisions, this being the most significant structural element of the market that is likely to impact upon competition. As the AEMC would be aware, retail competition is strongly linked to developments in regulated pricing. The current regulated pricing regimes that operate in New South Wales in respect of electricity and gas have been conducive to encouraging a competitive environment in respect of the retailing of both fuels. This is due to the fact that they allow for a sufficient level of retail headroom that enables and incentivises retailers to formulate competitive offers to attract consumers from regulated tariffs. However, the potential for sub-economic regulatory outcomes caused by regulatory decisions based upon imperfect information can serve as a significant disincentive for entry into the market, or the very least, a disincentive for the development of innovative products to meet the preferences of consumers.

The regulated price of electricity in New South Wales has been set at a sub-economic level in the past [2]. This had a significantly detrimental impact on competition, with retailers having very little opportunity or incentive to compete by offering market contracts at prices lower than the regulated rate, and as a consequence, churn rates for retail electricity in New South Wales were as low as 5% between 2004 and 2006.

In a market which is demonstrated to be effectively competitive, the most effective way to enhance competition is to remove regulatory intrusion into the price setting process.

Questions 7 and 8

Retailing electricity

Barriers to entry and expansion in electricity retailing are low. There are no material barriers to retailers acquiring electricity for resupply. The most significant costs that retailers face upon commencement of retailing electricity are the prudential and registration requirements necessary to become a participant in the NEM, and the costs of either developing a billing system or appropriately outsourcing this function. These costs must be faced by all retailers, however, and do not place incumbents at a particular advantage over new entrants.

French J of the Federal Court found in *AGL v ACCC*[3] that "the hurdles to entering the business of electricity retailing are reasonably low and the requirements for a licence are not onerous."

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[1] AEMO (2012). NEM Monthly Retail Transfer Statistics - September 2011 – December 2012

[2] IPART, 2004, "NSW Electricity Regulated Tariffs 2004/05 to 2006/07: Final Report and Determination", IPART Publication, Sydney

[3] *Australian Gas Light Company v Australian Competition and Consumer Commission* [2003] FCA 1525

There are currently 33 retailers licensed to operate in New South Wales, with at least six retailers actively marketing to small customers at any time. IPART has noted in the past that the number of retailers that have entered New South Wales and acquired customers is consistent with the conclusion that sunk costs and legal or regulatory differences between jurisdictions are not material barriers to entry [4].

IPART has also considered whether economies of scope and scale constitute a barrier to entry into energy retailing. Its consultants, Frontier Economics, concluded that while there are economies of scale associated with retailing, they are largely achieved at relatively low customer numbers, so that retailers operating at different scales can achieve similar average costs [5].

Retailing gas

As with electricity retailing, licensing requirements are not onerous. There are currently 17 companies holding current retailer authorisations, with at least four retailers actively marketing gas to small customers in New South Wales at any time.

A gas retailer must have (or be able to procure) access to wholesale gas supply and gas haulage arrangements in order to retail to customers. Existing and prospective retailers in the East Coast market should have sufficient access to wholesale gas supplies and to gas haulage arrangements in order to provide a competitive gas retail service offering.

Existing and prospective new entrants can source gas from Moomba or Longford along the Moomba to Sydney Pipeline or the Eastern Gas Pipeline. An additional production source, Patricia-Baleen, also feeds into the Eastern Gas Pipeline. The QSN Pipeline also provides a means by which gas from southwest Queensland can be transported to Sydney. Further, the development of the short term trading market in Sydney provides another option for sourcing gas.

Question 9

To the extent that the cost reflectivity of retail tariffs varies across geographic areas within New South Wales, this would be rectified by deregulating retail prices, as this would enable retailers to set prices at genuinely cost reflective levels while being constrained by competitive forces from setting prices above efficient levels over the long term.

AGL notes that Origin Energy recently stated in its submission to IPART's most recent review of gas prices that "in FY13 the tariffs in the former Country Energy area are forecast to deliver negative net retail margins and the tariffs in the Murray Valley/Albury area are expected to deliver margins well below a sustainable level." [6] This highlights the difference in cost reflectivity of standing offer gas prices across different areas of NSW.

However, while there exists a difference in competitive dynamics caused by geographical pricing differences across the State, this does not indicate a lack of competition across New South Wales more generally. Price deregulation provides a significant opportunity for tariffs such as these to be set at sustainable cost reflective levels.

This is not the case for electricity retailers, and retailers such as AGL actively market to customers in the Country Energy area.

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[4] IPART, *"Review of regulated retail tariffs and charges for electricity 2010-2013 – Final Report"* March 2010 at page 40

[5] NSW Government Energy Reform Strategy, Competition Memorandum, September 2009, at page 69

[6] Origin Energy, Submission to the Independent Pricing and Regulatory Tribunal on the review of regulated gas retail tariffs and charges from 2013 to 2016. Page 2

Market conduct

Question 10

High levels of competition exist between gas and electricity retailers in New South Wales, and retailers actively compete with each other to develop and market new products to existing and new customers and to grow their customer bases.

This highly competitive environment has incentivised the development of a number of product and service innovations, and improvements in the quality and scope of the products offered to customers. It is relevant to note that AGL has launched many of its most innovative products out of Victoria, which is seen as having a less risky commercial and regulatory environment given its deregulated retail pricing regime.

AGL's current suite of products incorporates such features and innovations as:

- discounts off energy usage charges;
- access to the Flybuys loyalty program;
- energy efficiency programs which enable consumers to reduce their overall energy usage;
- home energy services such as appliance installations and energy efficiency audits;
- solar PV products; and
- the ability for customers to monitor their energy consumption and usage patterns and to manage their accounts online through services such as AGL Online.

Question 11

Retail price regulation of electricity and gas impedes the potential for tariff innovation, product differentiation and service competition where the prices being regulated are in a market in which effective competition exists. There is no rational economic nor public policy explanation for the existence of price regulation in a competitive market. In fact, price regulation in competitive markets inhibits the exercise of customer choice and competitive market forces.

This is clearly demonstrated by statistics on comparative residential electricity churn rates by State between 2004 and 2012, which indicate that switching rates are highest in States in which there is no evidence of regulatory intrusion (eg. Victoria). These figures also show that over-regulation and sub-economic decision-making (as occurred in NSW between 2004 and 2006) result in significantly diminished competition and switching rates (switching rates in NSW were as low as 5% then). Tariff innovation, product differentiation and service competition were significantly stifled over this period of sub-economic regulation of electricity prices, with retailers having only very limited opportunities to compete by providing market contracts at lower prices.

Where price regulation is retained despite the existence of effective competition, then the only effective way to avoid inhibiting the competitive aspects of the market from operating is to ensure that the retail cost component of regulated default tariffs is set at a level which allows retailers to recover their costs, allowing them to develop products which provide appropriate returns in line with the market.

The fact that default electricity tariff caps applicable between 2004 and 2006 were set too low was acknowledged by the Australian Energy Regulator in its 2009 State of the Energy Market Report. [7] In its following price determination, IPART increased allowances for energy purchase costs, retail operating costs, retail margin and network charges, leading to an increased level of competition [8]. This is evidenced by increased customer switching rates in respect of electricity in New South Wales over the second half of 2009, accompanied by a declining proportion of customers on the regulated rates in each of the standard supply areas. Tariff price increases effective from 1 July 2010 have further improved competition in New South Wales, with relatively higher and more reasonable prices presenting retailers with a more attractive basis upon which to compete through market offers.

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[7] AER: Australian Energy Regulator, 2009, "State of the Energy Market", AER Publication, Melbourne. Page 207.

[8] IPART, "Promoting retail competition and investment in the NSW electricity industry, regulated electricity retail tariffs and charges for small customers 2007 to 2010, Electricity – Final Report and Final Determination", June 2007. Page 3

However, in an effectively competitive market, the best way in which to encourage tariff innovation, product differentiation and service competition is to deregulate prices and allow the market to set prices at an efficient level. Victoria, as the State in which electricity and gas prices have been deregulated for the longest period of time, should be viewed as a case in point. Victoria has consistently had the highest customer churn rates across the NEM States since the deregulation of its electricity and gas prices.

Further, the product and service innovations that AGL has developed and described in response to question 10 have been launched and marketed first in Victoria. While AGL develops its products with the capability of being able to offer them nationally, its most innovative products are generally launched and offered first in Victoria, which AGL views as being inherently less risky than other States in which it operates due to the absence of regulatory pricing intrusion.

Question 12

Basis for retail competition

Retailers can be expected to compete for the sale of electricity and gas to small customers in New South Wales to the extent that the expected return available will adequately compensate those retailers for participating in these markets. If the returns available are not adequate then these companies can be expected to allocate capital elsewhere.

The returns available to retailers are determined by a number of factors, but ultimately the regulated price which acts as a 'price-cap' in the market will act as an upper limit. The effect of recent regulated pricing decisions on small customer energy markets around Australia have been well documented.

In May 2012, the Queensland Government directed the Queensland Competition Authority (**QCA**) to exclude the main residential tariff (Tariff 11) from its 2012/13 price determination and announced a 'price freeze' at 2011-12 tariff levels plus an escalation for the cost of the carbon pricing mechanism. The impacts of setting the retail price without consideration of the costs and risks faced by retailers has reduced marketing activity, levels of product discounts and customer switching activity. Further detail on these impacts is discussed in submissions to a recent consultation by the QCA[9].

Take up of time of use pricing

AGL has, since around 2007, offered a time-of-use price to those electricity customers with an interval meter who are on a time-of-use network tariff. AGL's time-of-use price involves a straight pass through of the time-of-use network tariff component. Almost 15% of AGL's small electricity customers in New South Wales are on such a time-of-use price.

Likely impact of time of use tariffs

The availability of product innovations such as products that incorporate retail time-of-use pricing is likely to enhance competition, as consumers have greater choices available to them on how to structure their energy usage in the most efficient manner.

It would also lead to enhanced consumer welfare and improved asset utilisation rates. Recent research undertaken by AGL shows that where customers are free to choose whether to adopt a properly structured, retail time-of-use tariff product and where most customers do take up such products, more than 75% of customers would ultimately be better off with time-of-use pricing [10]. Further, the use of dynamic critical peak pricing (under which consumers would face cheap off-peak electricity rates, a more expensive peak rate, and a critical peak price on extremely hot days) applied to the 12 most extreme

[9] Origin Energy, Submission to the Queensland Competition Authority on the Consultation Paper: Regulated Retail Electricity Prices 2013-14, January 2013. Pages 17-20.

[10] Simshauser, P. And Nelson, T. (2013), "The outlook for electricity prices in 2020", CEDA 2013 Economic and Political Overview, CEDA Publication

weather events of the year improves load factors by about 8 percentage points in line with the economic analysis contained in Simshauser & Downer (2012) [11].

The business model used by AGL is driven entirely by customer choice, therefore consumers could choose to modify their consumption in their own way, including by making small adjustments to their air-conditioning thermostats on peak summer demand days, or turning off unnecessary household appliances at such times. This could lead to both savings on these customers' electricity bills and a saving of broader resource costs to society. AGL's modelling reveals that this would lead to material reductions in peak load electricity equipment and a greater utilisation of sunk assets.

Question 13

The growth in marketing efforts to small customers in New South Wales that has taken place particularly since the privatisation of the New South Wales Government's retail energy businesses indicates the high degree of competitiveness that exists between retailers of gas and electricity in the State.

Further, the expansion of different and more innovative marketing techniques and products in response to customer demand, such as the huge growth in sales through AGL's online sales channels, indicates retailers' responsiveness to customer demand and a tendency towards product innovation and differentiation in order to grow their customer bases.

Question 14

Electricity and gas retailers utilise a broad range of marketing practices when promoting products in New South Wales. Such channels include telephone contact; online promotions; door-to-door sales; advertising on billboards, in print media and on television; as well as via third parties such as brokers, intermediaries and aggregators.

Customers have responded positively to these marketing campaigns, evidenced by the high and increasing churn rates for both electricity and gas.

Question 15

The operation of the regulated price as a 'price-cap' in the market means that if the regulated price does not adequately account for wholesale market fluctuations, then the ability of retailers to offer products and services will be compromised.

In the absence of retail price regulation, wholesale market fluctuations should not impact the ability of a prudent and efficient retailer to offer products and services to small customers.

The extent to which energy retailers choose to expose themselves to fluctuations in wholesale electricity and gas prices is entirely dependent on the particular risk profile that the retailer wishes to adopt. Numerous financial hedging products are available to electricity retailers wishing to minimise their exposure to wholesale electricity price fluctuations. Similarly, gas retailers wishing to avoid purchasing gas from the wholesale pool are able to enter into appropriate contractual arrangements.

A key role for a retailer is to manage price and volume risk for their small customers in such a way as to enable them to offer a competitively priced retail product. If a retailer is unable to perform this function it will be unlikely to continue to operate in a competitive market over the longer term.

Question 16

Customers are generally influenced by a range of factors when choosing to switch from a regulated contract to a market offer contract, or to a product offered by a different energy retailer. These include factors such as price (eg. through the level of discount offered, or

[11] Simshauser, P. and Downer, D. (2012), "Dynamic pricing and the peak electricity load problem", *Australian Economic Review*, 45(3): 305-324

the amount of any switching fee that the customer will be liable for), convenience (eg. through different payment options), the availability of loyalty programs, and an ability to reduce their overall energy consumption. Generally, customers' overriding consideration will be the overall impact of these factors upon the likely cost of their energy usage.

AGL customers do not enter into leasing arrangements in respect of their solar panels, hence the issues raised by the Commission in its Issues Paper are not relevant for AGL.

Question 17

Access to energy related information

There is a wide range of energy-related information available to customers in a form that is easy to understand, relevant and up-to-date. The precise nature and format of this information is dependent on the particular product or service offered by the retailer. However, being able to provide customers with useful, high quality information is a form of product innovation and product differentiation that is being increasingly embraced by energy retailers.

AGL, for example, currently offers AGL Online, which enables customers to perform and manage a range of functions associated with their energy account, including obtaining access to current and historical bills online, and to view and monitor their historical energy consumption online.

AGL customers will soon be able to access an even higher quality of energy related information with the impending launch of a world class energy reporting and analysis tool. This will enable, amongst a range of other information, the provision of customers' energy consumption and usage patterns in as real time as their meters will allow. For example, customers with smart meters will be able to access hourly information up to the day before, review projected usage and bill estimates, and benchmark usage against similar households within their geographic region. Customers with manually read meters will be able to access information up to the time of their last bill, and benchmark usage against similar households within their geographic region.

Access to information that enables comparison

There is a plethora of information available to small customers that enable competing energy offers of various energy retailers to be compared. Not only do individual retailers provide detailed information about their products on their websites or at a customer's request, but independent brokers, and comparison services and websites exist, to which retailers provide and verify the information about the products they offer. Such facilities enable customers to readily compare the energy products offered by various retailers and make their choices accordingly. This will soon be complemented by the Energy Made Easy website, administered by the Australian Government and the AER, which will also enable the ready comparison of energy retailers' products in the various NEM States. This information will also be provided and verified by energy retailers themselves, thus enabling customers to be confident of its accuracy.

Customers' use of available information

In AGL's experience, customers do make ready use of the information available in the market when making the decision to switch products and/or energy retailers. AGL has, over the course of the 2012/13 financial year so far, acquired over 25% of its new customers through third party brokers, comparison sites and aggregators, and over the same time period Powerdirect has acquired around 47% of its new customers through brokers and comparison sites.

Contract expiry process

Prior to the expiry of a customer's fixed term contract with AGL, AGL will provide them with a range of information including the options available to them upon the expiry of their contract, including entering into a new market contract with AGL or accepting AGL's standing offer with AGL (for gas) or moving to another retailer.

Customers do not need to take any action to ensure a continuation of their energy supply. If the customer does not make a proactive choice, then they are rolled onto a new market contract with AGL under which they receive at least the same level of discount as they were previously receiving.

These processes will be reviewed and changed accordingly to comply with the National Energy Customer Framework (**NECF**) requirements once NECF is implemented in New South Wales.

Market performance

Question 18

At current prices for electricity standing offer contracts, AGL is of the view that retailers are generally able to recover the efficient costs of supplying small customers. The current regulated pricing approach employed by IPART has been successful in providing a framework that facilitates competition in the retail electricity market. This is evidenced by the recent levels of customer switching and the entrance of new participants in the retail market.

Market contract offers from retailers are designed to acquire customers while also providing a return in line with the retailers' requirements. Retailers will have different cost structures and required returns resulting from different business strategies. However, the nature of the regulated pricing framework with its long lead times and fixed pricing timeframes means that retailers will be exposed to additional risks, primarily that changes in the regulated price will affect the competitiveness of their offer.

At current standing offer contract prices for gas, AGL is generally able to recover the efficient costs of supplying small customers in the Jemena distribution network. In November 2012, AGL provided IPART with a pricing proposal for standing contract gas prices for 2013-16. In the proposal AGL proposed an increase in the current retail cost allowance of CPI+7.7% for 2013/14. As part of this increase, AGL proposed that the retail margin allowance be set at 8% of the total cost allowance which is based on the original margin range nominated by IPART in its final 2010-2013 price determination[12]. AGL remains of the view that unless margin allowances in the regulated price are set at levels which adequately compensate retailers for the risks involved in gas retailing, then retailers will deploy their capital elsewhere and competition will reduce.

On this basis, whether future profit margins will be sufficient to encourage further retail competition will depend on a number of factors. A key determinant will be whether IPART sets a sufficient retail cost allowance for retailers to compete in the NSW retail electricity and gas markets. As noted earlier, the risk that the regulated price is set at such a level that it limits the ability for retailers to compete is very real. As highlighted by AGL in a recent submission to IPART, the uncertainty resulting from significant changes in the east-coast gas market over the period means that there is significant risk that IPART could underestimate retailer costs and as a result damage the financial viability of existing retailers and undermine future retail competition.

Question 19

Energy retailers actively compete with each other to develop and offer products that meet the needs of New South Wales customers. AGL structures the development of its products so as to have the capability to offer them nationally. State-specific modifications are then made to products, such as discount levels, marketing channels, and any relevant changes necessary to comply with regulatory requirements, so as to tailor products to meet the specific needs of customers in a particular State. In this way, the needs and preferences of New South Wales customers are taken into consideration in developing products marketed in New South Wales, while the capability and structures exist for AGL to offer products nationally if this is considered appropriate.

AGL's dual fuel customers enter into a single contract for the sale of electricity and gas from AGL, however receive separate bills. This is due to differences in the timing of meter reaching schedules. If customers are billed for both fuels at the same time, then the bill for one fuel would most likely be based on an estimated rather than actual reading, which

[12] IPART, Review of regulated retail tariffs and charges for gas 2010-13, Gas – Final Report, June 2010, Page 32

would then have to be reconciled at a later stage. AGL considers it to be preferable to base bills on actual meter readings to the greatest extent possible.

Question 20

There is strong competition between retailers across all areas in New South Wales to retain existing customers and grow their customer bases. Retailers may choose to target customers in a particular distribution patch if that accords with the particular marketing strategy that is being employed, provided regulated price benchmarks provide sufficient margin to incentivise retailers to market in those areas.

A customer's geographic location within New South Wales, along with other factors such as the customer's behaviour (eg. discounts for paying on time) is one variable that may impact the particular product that is most appropriate for a customer to be on, or the level of discount that is applicable.

Questions 21 and 22

Every class of customer should be able to access the benefits of competition in New South Wales. While churn rates tend to be lower in regional as compared with metropolitan areas, the level of awareness by customers in regional areas of their ability to change retailers is expanding rapidly, and AGL has conducted successful marketing campaigns in these areas.

AGL offers a customer hardship program for those customers who are facing financial hardship which impacts their ability to pay their energy bills. Further, AGL is currently working with its Customer Council and other relevant stakeholders to address information asymmetries relating to market offer contracts, and to better understand and remove any barriers that vulnerable customers face in accessing the benefits of competitive market offers.

Identifying a path to removing retail price regulation

Question 23

Path to deregulation

AGL sees no reason to stagger the transition to a deregulated pricing environment, and considers that price regulation should be removed for all customers at the same time as has been done in South Australia. This would provide a healthy level of market stability and certainty, and ensure that the full benefits of competition, and tariff and product innovation, would be able to be utilised by all customers from the outset.

It would be especially important, during the initial period leading up to the commencement of the deregulation process, and during the transitional period before full deregulation is achieved, that any residual price regulation is managed in a way as to enable efficient, cost reflective pricing. This is the case under IPART's current price determinations, and this methodology should be retained in the lead up to deregulation so as to ensure the existence of ideal economic conditions under which to remove price regulation.

As noted in the Commission's Issues Paper, IPART recently proposed an "opt-in" regulatory pricing model for regulated retail electricity prices. AGL, in principle, supports this move toward deregulation because of the reduction in uncertainty that the removal of price regulation offers. However, in the broader context of the range of deregulation options under consideration, the "opt-in" approach is not ideal, and if such an approach were implemented ongoing regulation would be required.

Should the Commission be minded to recommend a more gradual transition to deregulation, AGL considers that the path to price deregulation that was adopted in Victoria in 2009 should be used as the model for New South Wales. On the basis of this approach, it would be sensible to transition small business customers to full price deregulation first, and after a 12 month period of time, transition residential customers to full price deregulation.

Customer consumption thresholds

The current 160MWh electricity and 1 TJ gas consumption threshold include residential and small business customers.

Residential consumption of electricity tends to fall within the range of 0 – 15 MWh per annum (with an average of around 5.8 MWh), and small business electricity consumption tends to fall within the 4 – 50 MWh per annum range (with an average of around 14.2 MWh).

Residential consumption of gas tends to fall within the range of 0 – 50 GJ per annum (with an average of about 18.9 GJ) and small business gas consumption tends to fall within the 20 – 500 GJ per annum range (with an average of about 121.5 GJ).

Consumer protections

It would be important to conduct a public awareness and education campaign during the transition to full deregulation of retail prices. This should provide customers with guidance on how and where to source information on the range of energy offers available to them, and the nature of the protections available to them.

NECF, which the New South Wales government has announced will be introduced into New South Wales on 1 July 2013, was designed to provide a suitable consumer protection framework for a deregulated energy market.

In particular, there will be an obligation on the Financially Responsible Market Participant to offer a standing offer contract to consumers at a site if requested. There is a limitation on a retailer's ability to change the price of its standing offer contract more frequently than six monthly. Further, there is an obligation on retailers to provide details of their generally available offers to the independent price comparator website (which is currently operated by IPART, and will be operated by the AER once NECF is implemented in New South Wales) to enable customers to be able to compare all products available to them. Importantly, there can be provision for price monitoring by IPART alongside NECF, as is the case in Victoria with the Essential Services Commission and South Australia with the Essential Services Commission of South Australia.

These protections will not in any way be eroded in a deregulated pricing environment, therefore there is no need for additional consumer protections to be implemented.

Improving the effectiveness of competition

Question 24

Effective competition exists in respect of retailing electricity and gas in New South Wales. Barriers to entry are low, customer churn rates are high and trending upwards, and retailer marketing activities are significant and increasing. While gas customer churn rates are not as high as electricity, at around 14% they are healthy, and are indicative of a customer base that is willing and able to switch retailers to select the product most appropriate to them.