EnergyAustralia Pty Ltd
ABN 99 086 014 968
Level 33
385 Bourke Street
Melbourne Victoria 3000

Phone +61 3 8628 1000
Facsimile +61 3 8628 1050

enq@energyaustralia.com.au
energyaustralia.com.au

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Chris Spangaro
Senior Director
Australia Energy Markets Commission
Level 6, 201 Elizabeth St
Sydney, NSW

Submitted online at www.aemc.gov.au

Dear Mr Spangaro

Submission to the 2014 Retail Competition Review

EnergyAustralia welcomes the opportunity to provide input to AEMC's 2014 Retail Competition Review.

1. Introduction

EnergyAustralia is one of Australia's largest energy companies, providing gas and electricity to over 2.7 million household and business customers in NSW, Victoria, Queensland, South Australia and the Australian Capital Territory. 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.

2. EnergyAustralia Response to Questions Raised in the Approach Paper

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.

We support the proposal to base the analysis upon market definitions determined by jurisdiction (noting the proposed different treatment for Queensland) and by fuel type (electricity and gas).

Some may argue for a further disaggregation along business and residential customer lines. However, as the Commission's review is explicitly focusing upon small customers only and therefore excludes large business customers, the argument in favour of such a distinction is not compelling. While retailers may choose to treat the large and small customer segments as separate markets and make separate market entry/expansion/exit decisions accordingly, retailers generally don't make the same distinction between small business and residential customer classes.

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?

We consider that retailers play a vital role in communicating with customers, both through our direct written and verbal contact with our customers, and our more general marketing activities.

Further, for customers seeking impartial information, it would seem that regulator online price comparator sites such as the AER's are a key part of helping customers get the best out of the market.

EnergyAustralia supports the ongoing development of the AER's Energy Made Easy web comparator to provide customers with an impartial view of energy prices and offers our support to the AER (and other jurisdictional regulators operating similar comparators) in terms of providing our customer insights to ensure that these comparators contain the information which best meets consumer needs.

We note that in jurisdictions where the National Energy Customer Framework (NECF) is yet to be applied (Victoria and Queensland) that customers cannot access Energy Made Energy and that less sophisticated price comparators are run by local regulators.

We also consider that there will be customers or categories of customers that will need additional assistance (for example with flexible pricing). EnergyAustralia is constantly changing information provision practices, within existing regulatory frameworks, in response to consumer needs.

3. What motivates small customers to switch from a standing (or regulated) offer to a market offer?

In our experience customers are motivated to take up market offers based on a range of factors including discounts, green power, solar feed in tariffs, acquisition incentives, dual fuel and payment channels.
However, energy is a relatively low interest product or "grudge purchase" for most consumers and therefore a proportion of customers are reluctant to, and maybe will never, accept or seek a market offer. Many standing offer customers are comfortable with the service offered by their local retailer and therefore do not wish to spend time and effort investigating market offers.

This is particularly the case for itinerant customers that are keen to have a simple supply that does not require any of their attention and hence they often default to a standing offer and take no action to change this form of contracted supply.

4. What motivates small customers to switch energy retailers?

The competitive retailing of energy is not unlike any other product and is influenced by the four Ps of marketing, product, place, price and promotion.

Customers are increasingly becoming more aware of their ability to access the competitive energy market and using this knowledge to benchmark their existing supply package and or to seek alternative offers that better suits their needs. Customers now demand choice in all of their purchases and will seek alternatives to achieve a better price and service offering. In some cases this requires a switch of retailer and can be influenced by various marketing initiatives such as:

- Online marketing initiatives;
- Third party comparator and sales channels;
- Independent website comparators;
- Above the line advertising;
- Direct marketing; and
- Door to Door sales.

Often a positive sales or marketing experience will be enough to influence a customer to switch energy retailers. In the same way a negative experience related to billing, service order, tariff or general customer query will be sufficient to sway a customer into seeking an alternative retailer.

A strong brand or product alliance is also are also influential factors that can cause customers to change retailers.

5. What are the reasons behind some small customers remaining on a standing (or regulated) offer rather than shopping around for a market offer?

See question 3 above.

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

In our view there are no barriers preventing customers from switching retailers or switching plans with their existing retailer.

Some consumer groups argue that exit fees for customers switching retailers prior to the end of their existing contract or benefit term create a barrier to switching. Such fees are generally quite low and enable retailers to offer inducements before and during the contract period. Some retailers will even pay the exit of a customer's previous retailer to encourage them to switch. Exit fees do not commonly apply if a customer switches products with the same retailer.

As outlined further below there have been some complaints around switching times largely caused by the quarterly meter read cycle in most jurisdictions. The AEMC is discussing options for improvements in this aspect of the transfer process.

The rate of customer switching in the NEM, which is one of the highest in the world, appears to indicate that these minor restrictions are having minimal impact on participation in this market.

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?

The risk associated with regulated pricing poses potential a barrier to entry. In jurisdictions where prices are regulated, there is no guarantee that prices will be set at a level which enables market participants to recoup costs from one year to the next.

8. Have the barriers referred to above dissuaded retail businesses from entering, expanding within, or exiting the market?

EnergyAustralia has limited visibility of the strategic direction of its competitors and is therefore unable to make definitive statements about the drivers behind their market participation or lack thereof. We point however, to the high number of active retailers in Victoria as evidence that removal of price regulation equates to the dismantling of a significant barrier to entry.

9. Are the barriers referred to above likely to persist or abate in the future?

See above

Independent rivalry

10. To what extent do energy retailers compete with each other in terms of price or product/service differentiation to acquire new, and retain existing, small customers?

There is a high degree of competitive rivalry in the Victorian, New South Wales, South Australian and (South East) Queensland markets, with strong price and non-price based competition between large and small energy retailers to win new customers and retain existing customers.

The level of electricity and gas switching activity reported by AEMO continues to place these jurisdictions among the most competitive energy markets in the world. The annualised electricity switching rates for January 2014 in these jurisdictions ranged between 11 and 25 percent, while the annualised gas switching rates were between 9 and 26 percent.[1]

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. Owing to the competitive nature of the local industry, retailers have looked to develop new products to meet the needs of customers and improve service (for example, through upgraded billing and customer management IT systems). As an illustration, EnergyAustralia offers the regulated rate or standing rate (depending upon the jurisdiction and whether or not they have regulated retail tariffs), discounted rate products (with varying discounts and contract benefit term lengths), a fixed rate product (that allows customers to lock in their rates upfront for two years), time of use options in both Victoria and NSW (from smart meters in Victoria and manually read interval meters in NSW), together with a range of features, such as:

- Dual fuel products – for those customers wanting both gas and electricity;
- Acquisition offers - eg magazine subscriptions, gift cards, rebates;
- Bill payment smoothing functionality (ie. our "SmarterPay" offering) ;
- GreenPower accredited product add ons; and
- Solar feed in tariffs.

EnergyAustralia has also developed the online "eWise" tool, which provides tailored information on customers' energy usage, allows progress tracking of energy consumption and spending, and suggests ways for our customers to use energy more efficiently.

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[1] For electricity switching statistics, see: http://www.aemo.com.au/Electricity/Data/Metering/Retail-Transfer-Statistical-Data . For gas: http://www.aemo.com.au/Gas/Market-Data/Gas--Retail-Transfer-Statistical-Data

11. What sort of product and/or service improvements have retailers delivered to small customers in electricity and natural gas retail markets?

See response to 10.

12. In those jurisdictions where price regulation is in place, has retail price regulation encouraged, or impeded, tariff innovation or product/service innovation in 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.

For example, in the NSW retail market, even though there is significant competition 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.

13. In those jurisdictions where price regulation has been removed, has retail price deregulation encouraged, or impeded, tariff innovation or product/service innovation in small customer electricity and natural gas retail markets?

The removal of retail price regulation has allowed retailers to compete more vigorously in those jurisdictions where it has been implemented with a number of retailers competing only in deregulated markets offering products would not otherwise have been available to consumers. For example, the range of discounts available in deregulated markets (Victoria and South Australia) is far larger than those available in regulated markets, which suggests price regulation inhibits product innovation.

The full impact on product and service innovation has been muted to some extent by the fact that price regulation remains in a number of jurisdictions. Retailers operating across regulated and deregulated states are constrained as developing different products and processes for each jurisdiction eliminates the economies of scale that would otherwise be achieved. The full benefits of deregulation will only be felt by consumers when it has been extended to all jurisdictions.

Conversely, the service innovation which has arisen as a result of deregulation in a number of states has flowed through to the regulated jurisdiction because of the same principle.

14. What types of marketing practices, or business behaviours, have small customers experienced in different electricity and natural gas retail markets?

There is a high level of marketing activity, as would be expected with the strong level of competition that exists in most of the NEM jurisdictions. Different types of marketing are pursued, including online, kiosks, telephone marketing, etc.

In addition to these retailer-led marketing channels, 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 marketing through online channels.

Our experience indicates that the increasing range and the types of marketing channels suggests that the market is very competitive and that retailers wishing to obtain or maintain a presence in the markets need to be proactive in developing new sales approaches.

Our experience also indicates that the industry needs to listen to, and practically respond to, consumer feedback about their energy sales experiences. For example, we ceased selling via the door-knocking channel in 2013, as this sales channel was unpopular with consumers and led to low customer satisfaction.

15. Are customers satisfied with the service quality they receive from their energy retailer(s) and the value for money?

With energy prices having increased dramatically over the last several years, we understand that customer awareness of, and dissatisfaction with, the energy industry has risen to a high level. Retailers are being held more accountable for competitive market outcomes by customers, governments and regulators more than ever before. This means that retailers have a much bigger opportunity to succeed, or fail, based on their sales and service performance alone.

The following initiatives are just some of the steps we've taken in recent times to improve service offerings for our customers:

We are continuing to improve the quality of content on our website to make it more user friendly, relevant and useful for our customers. For example, we have:

- established "eWise", an energy management system that redefines the way customers can understand energy information, track their usage, and make informed choices and savings that are directly relevant to their situation.
- improved our online quoting tool, so that it uses accurate usage data for customers and confirms their exact meter type before providing a price comparison.
- We've taken steps to amend our customer contract terms and conditions to ensure they are easier to read and understand and avoid legal jargon as much as possible. These improvements are ongoing.

Similarly, we established a corporate 'tone of voice' for all customer communications via phone, email, letter and text message. Under this policy, we try to use simple, active and direct language in all dealings with our customers.

In Victorian we are offering tailored products to suit the usage profile of customers. Interval data, provided by smart meters, enables us to match a household's energy consumption to the right product for them.

16. Are customers satisfied with the level of choice available in the market?

There are now up to 20 retailers operating in jurisdictions in the NEM servicing small customers. While there have been some mergers in the market several new retailers have also entered the market such as People Energy, Powershop and Blue NRG. Customers appear to be satisfied with the level of choice as they are accessing offers by all of these retailers. EA is not aware of instances whereby customers have requested more choice in the market.
Most retailers provide a variety of market offers to small customers and more recently in Victoria flexible pricing has been introduced. Flexible pricing is a relatively new concept for consumers and requires targeted simple communication to educate and avoid customer confusion. The Victorian government has sought guarantees from retailers to limit their flexible product offerings in order to protect customers from too broad a choice of flexible offers. Going forward these restrictions will be

lifted ensuring the choice of offers is extended delivering tailored products of all customers and maximising the benefits of smart meters.

17. Are customers satisfied with the ease and speed with which they can switch retailers?

Switching rates in the NEM are among the highest in world suggesting that customers are not concerned with the switching process with many customers churning multiple times. Nevertheless the AEMC is currently conducting a review of switching times in the NEM as direct by SCER. This review was instigated following the Power of Choice review which published a comparison of switching times around the world highlighting that the maximum switching times in the NEM can be as high as 65 calendar days. This is largely driven by the quarterly meter reading cycle in most jurisdictions and the requirement for transfers to be triggered by an actual read.

A review of switching data provided by AEMO suggests that the average switching time in the NEM is around 30 calendar days. The AEMC report notes an increase in complaints to ombudsman regarding the customer transfer process but also acknowledges that these complaints are a relatively small proportion of overall transfers.

EA and other retailers were surprised by the SCER recommendation to investigate transfers times as we believe this to be a minor customer issue that will largely be resolved by the introduction of smart meters where meter reads will be more readily available. This has proven to be the case already in Victoria where switching times are reducing due the almost complete roll out of smart meters. Nevertheless EA together and other retailers, while participating in the AEMC Review of electricity customer switching, are independently investigating options to onboard customers sooner if they believe that customers will value this.

18. Is there evidence of any long term jurisdictional or cross-jurisdictional trends in the number and nature of customer complaints to retailers or ombudsman?

While EnergyAustralia analyses complaint levels in order to address issues and improve customer service we have not thoroughly analysed long term trends in customer complaints in the context of external drivers. While we are aware of these drivers and can often anticipate short term spikes or troughs in complaint levels on the back of external events, it is difficult to establish their longer term impact.

A number of the external factors which may have impacted complaint levels are:

- Increased media coverage and politicisation of energy industry issues;
- Increased customer awareness and accessibility of Ombudsman Schemes;
- Sustained price increases; and
- Significant industry upheaval in most jurisdictions (eg, price deregulation, NECF, Smart Meters, etc).

Notwithstanding these issues, EnergyAustralia is aware that some of the increase in complaints was driven by internal factors, particularly around the introduction of a new customer care and billing system. Other major retailers which have also introduced new systems in recent times have experienced similar increases in complaint levels. These increases are likely to occur to across jurisdictions whereas the impact of external events outlined above are generally more localised.

Retailer outcomes

19. How does the presence of price regulation affect retailer risk profiles and retailer risk management strategies?

The risk associated with price regulation is most profoundly visible in its impact as barrier to entry. As the first jurisdiction in which retail pricing was deregulated, Victoria enjoys vigorous competition from a large number of retailers on both price and non-price product features. Although healthy competition exists in a number of other jurisdictions, it is characterised by a smaller number of market participants.

Price regulation creates considerable risk for retailers as it removes any certainty that a retailer will be able to recover costs over the medium term. 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 investment and innovation even where margins are otherwise adequate.

Due to the nature of the price determination process in regulated jurisdictions, a determination which provides what a prospective retailer may consider to be an accurate reflection of costs plus an appropriate profit margin may be insufficient to encourage market entry as there is no certainty that following years' determinations will allow cost recovery.

In order to manage the risk associated with price regulation, an efficient retailer will be more conservative when offering market offers which give a discount off the regulated rates as these discounts may not be sustainable on longer term retail contracts (2 or 3 years) under less cost reflective price determinations. Further, the incentives for a retailer to expand their customer base are diminished where low margins exist so retailers will not engage in vigorous acquisition campaigns.

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?

Without providing a full view of EnergyAustralia's thoughts with regard to each of the current regulated tariffs in existence in the NEM, we are of the view that we are generally able to recover costs. We consider however, that in many instances regulators have understated input costs and consequently the headroom/margin component of the regulated tariff is unrealistic as a considerable portion of this component is taken up covering the other cost components, typically wholesale energy costs and retailer operating costs. In jurisdictions where an explicit headroom allowance is included in retail price determinations, it provides a perception of retailer margin which is grossly overstated.

With regard to market offers, as these are generally lower than regulated tariffs, the retail margin issue is compounded. Where regulated tariffs are set as the benchmark, retailers must discount in order to compete in the market. As outlined above, in many instances the retail margin on regulated prices is already quite thin, to further discounting simply limits each retailers' capacity to innovate or differentiate in the market due to the costs involved.

21. Is there evidence of a material divergence in the level of competitive market costs between any of the jurisdictions where market offers are available?

Each NEM jurisdiction has its own peculiarities with regard to the costs involved. These have generally arisen through differences in the regulatory regime, government policy or are legacy issues which have arisen through the evolution of those markets. The most noteworthy case in point is the Victorian market where retailers face considerable costs as a result of the smart meter rollout. Although smart meters offer a range of benefits to consumers, the development of products, systems and process to support advanced metering infrastructure has been costly and consumers have not yet embraced the technology to a point where the outlay has been recovered.

Where retail price regulation remains, the variance in the costs faced by retailers from one jurisdiction to the next is managed to the extent that the jurisdictional regulator recognises these costs.

22. Is there any evidence to explain the underlying cause(s) of any material inter-market divergence in retailer costs (ie the costs faced by the retailer)?

See above

3. Summary

EnergyAustralia strongly believes that competitive markets provide optimal outcomes for consumers. Where such markets exist we seek to compete vigorously and provide consumers with the product and service offerings which best suit their needs.

If you would like to contact me about this submission, please call (03) 8628 1731.

Yours sincerely

Joe Kremzer
Regulatory Manager