INFORMATION

AUSTRALIAN ENERGY MARKET COMMISSION LEVEL 6, 201 ELIZABETH STREET SYDNEY NSW 2000
T: 02 8296 7800 E: AEMC@AEMC.GOV.AU W: WWW.AEMC.GOV.AU

2017 Retail Energy Competition review – NEM-wide

Consumers are experiencing increases in retail electricity prices. These price increases are a consequence of higher wholesale energy market costs.

Increasing wholesale energy market costs are being driven by a range of factors, including the increasing costs of hedging contracts which is a result of the lack of an emissions reduction policy that is properly integrated with the energy market, generator retirements and higher gas prices.

In the context of retail energy markets, consumers are exercising their choices, looking to take up new technology options and there is increasing diversity of retailers and energy service providers entering the market. These suppliers are providing products and services that are aligning with consumer preferences to manage their energy use and bills.

Key findings in relation to the state of competition

The Australian Energy Market Commission (AEMC) retail energy competition reviews are undertaken at the request of the Council of Australian Governments Energy Council. This year's review assesses how competition is evolving and the outcomes it is delivering for residential and small business gas and electricity consumers across the National Electricity Market (NEM).

Based on the assessment of the key measures and indicators considered for the review, there have been changes to the nature of retail competition and the outcomes for consumers.

Overall, there are opportunities and challenges to enhancing the effectiveness of retail competition which are due to:

- changing consumer preferences and the growing diversity of products and services
- market structure, retail pricing and margins
- upward pressure on retail prices due to influences external to the retail energy market.

Changing consumer preferences and growing diversity of products and services.

- *Consumers have more options to manage energy use and are exercising those options*. Around 20 per cent of consumers have solar panels and around 21 per cent of consumers indicated that they were definitely or likely to adopt battery storage in the next two years.
- *Consumer awareness of choices is high, but knowledge about the plans they are on is limited.* In NEM jurisdictions where consumers have an active choice, around 80 per cent of consumers surveyed indicated that they actively chose the energy offer they are on now. While this is the case, consumer understanding of differences between market and standing offers and the different retail tariff structures is low. Thirty per cent of respondents were not able to identify the type of offer they were on.
- *Consumers who switched found it harder to compare energy offers than in other sectors, yet switching rates are higher in electricity than other sectors*. This is coupled with low awareness of Energy Made Easy. Awareness remains at nine per cent.

Consumers are experiencing price increases as a result of high wholesale market energy costs.

- *In NEM jurisdictions where consumers have an active choice of retailer, 47 per cent of residential and 54 per cent of small business electricity consumers have not switched retailer or plan in the past five years*. A higher proportion, 57 per cent, of residential gas consumers had also not switched retailers in the last five years. Behavioural biases may contribute to why some consumers do not investigate options or shop around for a better deal. This implies that consumers may not be accessing savings available in the market.

- *Across the NEM, satisfaction of residential electricity consumers with their current retailer and customer service provided remained stable at around 74 and 71 per cent respectively*. Residential consumer satisfaction with the value for money provided also remained stable at 61 per cent. However, residential gas consumer satisfaction decreased by 6 per cent and is now at 60 per cent.

- *Consumer satisfaction for small business electricity consumers decreased. In particular, value for money decreased by 11 per cent to 48 per cent across the NEM, with Victoria experiencing the largest decrease of 18 per cent.* Consumer satisfaction for small business gas consumers remained stable.

- *Shifts in consumer preferences and attitudes about how they consume energy, coupled with rapidly evolving technology, have created opportunities for retailers and new energy service providers to diversify their product and service offerings.* There are a range of new energy service providers that have entered the market utilising technology, digital platforms and software solutions to create simple service offers for consumers. This is being done both independently and in partnership with retailers. This increasing competitive pressure from retailers with different business models is forcing traditional retailers to compete not just on price, but also on value-added product and service offerings.

- *Embedded networks represent a new way of providing retail energy products and services to consumers*. They are increasingly being provided by non-traditional energy suppliers, such as property developers or intermediaries that are associated with property developers. There has been significant growth in embedded networks over recent years, especially for supplying residential consumers. Between 2010 and 2016, the number of registered residential embedded network exemptions rose from virtually zero to over 1,300. Most of this growth has occurred in Queensland since 2014. While there are potential benefits for consumers being in embedded networks, there are also issues with the ability of these consumers to access competitive retail market offerings and the level of consumer protections.

Improving retail market structure

- *Market concentration has decreased.* The market share of customers for the 'Big 3' retailers (AGL, Origin and EnergyAustralia) who together currently supply 70 per cent of customers in the NEM, decreased and the market share of second tier retailers increasing.

- There is increasing diversity amongst the types of second tier retailers including those with generation assets (such as Lumo-Red and Simply), and those with no generation assets (such as Sumo and Mojo). Some retailers have begun to offer battery and solar products that allow a customer to vertically integrate behind the meter.

- *A lack of liquidity in the contract market was identified by retailers as creating a barrier to entry and expansion, and increasing the benefit of owning generation assets.* Retailers observed that the cost of hedge contracts has increased and this is increasing risks and costs to businesses operating in retail market and hence increases in retail prices. Limited access to competitively-priced risk management contracts was particularly seen as a significant barrier to entry, particularly in South Australia.

- The above highlights the degree to which a competitive, reliable supply of energy depends not only on investment in capacity, but also on the need for that capacity to supply hedge contracts. This in turn will be affected by how generation capacity is financed.

There is increasing diversity in retail offers and new retailers and service providers entering the retail energy market.

Retail price innovation is emerging, slowly and larger discounts available

- *The diversity of retailers has been accompanied by differentiated price offers for consumers, including "all you can eat" offers, subscription models and energy-pack options*. Despite these new offers, pricing innovation remains limited, although additional innovation may follow reforms to distribution network tariffs and competition in metering which take effect on 1 December 2017. Discounting by competing retailers is resulting in higher levels of price dispersion over time in NEM jurisdictions where there is an active choice of retailer.

- *The spread of standing and market offers for this year shows that discounts available in 2017 are higher than those in 2016.* Across NEM jurisdictions with an active choice of retailer, and for the representative consumer that moved from the median standing offer to the best market offer, the discounts as at 5 January 2017 ranged from:
    - 12 to 38 per cent, or $170 to $507 per annum, for electricity bills
    - five to 30 per cent or $44 to $285 per annum, for gas bills.

Retail margins based on voluntary retailer data provided

- For this year's review, information voluntarily provided by the Big 3 retailers and some smaller second tier retailers, made it possible to assess gross margins.
- Over the period of 2014-15 to 2015-16 the gross margins for the big 3 retailers:
    - were larger across New South Wales and Victoria than gross margins of smaller second tier retailers in 2014-15, but similar to the gross margins of smaller second tier retailers in 2015-16.
    - decreased overall across New South Wales, Victoria, South Australia and South East Queensland. This is due solely to the decrease in gross margin in South East Queensland. Retail prices were deregulated in South East Queensland from 1 July 2016.
    - were higher in Victoria than in other jurisdictions. As part of its inquiry into retail electricity supply and pricing, the ACCC may consider investigating the differences in retailer costs for different jurisdictions, in particular Victoria.

There is upward pressure on retail prices, and in turn pressure on smaller retailers, driven largely by a distortionary emissions reduction policy

- *Retailers that are not vertically integrated are reliant on firm-capacity hedging contracts to hedge their risks and underwrite their fixed-price retail offerings.* The design of the large-scale renewable energy target (LRET) has resulted in an increasing penetration of variable renewable electricity generation, but this has not been accompanied by an increase in firm-capacity hedging contracts. These contracts are used by retailers to hedge their risks in the wholesale electricity market. These generators have not been incentivised to offer firm-capacity contracts due to earning revenues from the sale of 'green' certificates. The new renewable electricity generation has also contributed to the retirement of generators that offered firm-capacity hedge contracts. This has therefore reduced

The 2017 retail competition review makes a number of recommendations to enhance competition in retail electricity and gas markets and improve consumer outcomes

the overall supply of these hedging contracts and increased their costs to retailers and, in turn, to consumers.

- *The reduced availability and higher cost of hedging contracts may negatively impact the competitive position of the standalone new energy retailer businesses.* These retailers are currently partnering with the new energy service providers, and driving the emerging value-added product and service competition that enables consumers to better manage their energy use and bills.

Recommendations

The report makes a number of recommendations that relate to enhancing competition in NEM retail energy markets and improving consumer outcomes. These include:

Recommendation 1: A broad information program is developed by Energy Consumers Australia (ECA) in partnership with the jurisdictions that would support consumer awareness and confidence in the options that are available to manage energy bills. This information program would be developed as soon as practicable given recent and significant price increases. The work would apply the AEMC consumer blueprint that highlights and identifies the various channels needed to effectively communicate across and within consumer segments and also the broader community.

Recommendation 2: The AER is resourced to run an effective awareness campaign of their Energy Made Easy website and are resourced to maintain and develop the site.

Recommendation 3: The AER consider opportunities to improve the:

- Information provided by retailers to consumers related to the comparison of retail market offers.
- Transparency of information provided to consumers in relation to expiring fixed benefit periods in market offers.

The AER may need to consider whether amendments to its retail pricing guidelines are required or whether rule change requests need to made to the AEMC.

Recommendation 4: As a priority, retailers and distributors make it easier and limit delays for consumers (and their agents) to access their consumption data. In particular, retailers and distribution network businesses develop streamlined arrangements for obtaining informed consent from consumers to the provision of metering data to their authorised representatives. The work by ECA and electricity distribution network businesses on streamlining information requirements from consumers and their agents should continue. In the absence of any industry progress, the ECA may consider if changes should be requested to the National Electricity Rules and National Energy Retail Rules.

Recommendation 5: Retailers, consumer advocates and jurisdictions assist in transitioning vulnerable consumers, particularly those on hardship plans or experiencing payment difficulties, away from higher priced standing offers or market offers with expired fixed benefit periods.

Recommendation 6: COAG Energy Council write to COAG and the relevant jurisdictions to review the application of their energy concession schemes with a strategy on awareness of energy concession schemes among different consumer segments.

Recommendation 7: Jurisdictions to harmonise their energy customer protection arrangements so that barriers and costs for traditional and new retailers who operate across the NEM are minimised. To facilitate this work, COAG Energy Council request the AEMC to provide advice on the existing suite of modifications that have been made by jurisdictions to the National Energy Customer Framework (NECF) and the differences between NECF jurisdictions and Victoria. This program of work should be completed within two years.

Recommendation 8: Noting the progress made to date, COAG Energy Council should continue to consider how the NECF can be reformed given the diversity of new retailers, service providers and product and service offering available in the competitive retail energy market.

Recommendation 9: Industry develops a credible survey to address the lack of data for electricity trading hedging products. In the absence of industry action, the AEMC will consider, as part of its G20 over the counter derivatives review, whether electricity OTC products should continue to be exempt from derivative trade reporting requirements.

The 2017 retail competition review considers how competition is evolving and outcomes it is delivering for residential and small business consumers

Background

The AEMC retail competition reviews were initially undertaken to support the commitment made by jurisdictions in 2004 to deregulate retail energy prices where effective competition could be demonstrated. Since our last annual review, most major NEM jurisdictions now have deregulated retail energy markets. Given the extent of deregulation, this year's review focuses on how competition is evolving and the outcomes it is delivering for residential customers and small business consumers, excluding large industrial and commercial users.

To consider the overall effectiveness of competition in retail energy markets, the review applies a range of market measures and indicators against a structure-conduct-performance framework. The market measures and indicators are not considered in isolation, as no single measure or indicator captures all the information about the effectiveness of competition in the retail energy services market. Instead, the review assesses evidence provided by a range of indicators and measures and their trends over time. The analysis of measures and indicators uses market and retailer data, quantitative consumer research, a retailer survey and stakeholder feedback.

For information contact:
AEMC Chairman, **John Pierce** (02) 8296 7800
AEMC Senior Director, **Kris Funston** (02) 8296 7811
AEMC Director, **Alan Rai** (02) 8296 0600

Media: Communication Director, Prudence Anderson 0404 821 935 or (02) 8296 7817

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