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Report prepared for the Australian Energy Market Commission

# Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales - Report of Interviews with Energy Retailers

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## About Sapere Research Group Limited

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Sapere Research Group is one of the largest expert services firm in Australasia and a leader in provision of independent economic, forensic accounting and public policy services. Sapere has over 50 economic and forensic accounting experts providing independent expert testimony, strategic advisory services, data analytics and other advice to corporate clients, major law firms, government agencies and regulatory bodies.

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# 1. Glossary

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ACCC	Australian Competition and Consumer Commission
AEMC	Australian Energy Market Commission
AER	Australian Energy Regulator
C&I	Commercial & Industrial
EAL	Energy Assurance Limited
ERAA	Energy Retailers Association of Australia
ESAA	Energy Supply Association of Australia
ESCOSA	Essential Services Commission of South Australia
ETEF	Electricity tariff equalisation fund
FRC	Full retail competition
IPART	Independent Pricing and Regulatory Tribunal of NSW
MCE	Ministerial Council on Energy
NECF	National Energy Customer Framework
NEM	National Electricity Market
SCER	Standing Council on Energy and Resources
SME	Small and Medium Enterprises
STTM	Short term trading market
TOU	Time-of-use
VTPA	Voluntary Transitional Pricing Agreement



## Executive summary

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The Australian Energy Market Commission (AEMC) is conducting a review into the effectiveness of competition in the small customer electricity and natural gas retail markets in NSW (NSW Review). To help inform the NSW Review, the AEMC commissioned Sapere Research Group (Sapere) to conduct interviews with retailers licensed to operate in NSW and with the two energy industry associations, the Energy Retailers Association of Australia (ESAA) and the Energy Supply Association of Australia (ESAA).

This report presents the views and perceptions of respondents who participated in the interviews. The key findings from the interviews are summarised below.

### Key findings

#### Overview of participating retailers

The 16 retailers interviewed for this review all hold an electricity licence in NSW. Of this sample group, 13 are active in the NSW market. In this group of 13 active retailers, 11 are actively retailing to residential and/or small business customers. Nine of the active retailers are vertically integrated with generation assets – either through ownership, contracting arrangements or joint venture arrangements. Four of the active retailers are not vertically integrated with wholesale electricity assets and are pure electricity retailers.

Ten of the retailers interviewed hold a gas licence. These retailers all hold an electricity licence. Of the ten licensed gas retailers, six are actively retailing gas in NSW. Of these retailers only the big three retailers have upstream gas interests.

#### Views on competitiveness of the NSW market

The majority of respondents consider retail competition in electricity to be strong and active. This view is based on the activities of the retailers and the receptiveness of customers. The uniform view is that competition is being driven by aggressive marketing strategies engaged in by the big three retailers. Respondents consider that the retailing activities of the big three retailers has markedly increased following the privatisation of the NSW Government-owned retailers in March 2011.

Whilst new entrants are active in NSW, the extent of their current activity is considered to be somewhat muted. Respondents consistently said that the level of activity of new entrants in NSW is much lower compared to the level in Victoria. The difference in the success of new entrants in NSW compared to Victoria emerged as a key theme during the course of the interviews. NSW and Victoria introduced full retail competition at around the same time in 2002. During the AEMC's 2007 review of the effectiveness of competition in Victoria, the market share of new entrant electricity retailers was found to be around 20 per cent.<sup>1</sup> In contrast, the market share of new entrant electricity retailers in the NSW market is currently

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<sup>1</sup> AEMC 2007, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria, First Final Report*, 19 December 2007, p.34.

around 5 per cent.<sup>2 3</sup> This situation is largely attributed to the lack of headroom in the regulated prices in NSW.

## **Level and extent of retailer rivalry**

### **Retailer rivalry in electricity**

The majority of respondents rated the level of retailer rivalry in electricity as high to very high. Respondents that rated retail rivalry to be very high based this view on observations of increased door knocking activity; high level of discounts on offer; and aggressive customer retention strategies by the big three retailers. Other retailers said that there has been an increase in retailing activities in regional areas since the privatisation of the NSW State-owned retailers in March 2011.

Several respondents noted that market share in NSW is aggregated around the big three retailers. In particular, new entrant retailers have less market share in NSW than in Victoria where there is a “much more even spread of the pie” in terms of new entrants winning customers. Retailer rivalry in NSW was marked down on this aspect by some of the respondents.

Retailers are primarily competing on a price, discounts or cash rebates. More recent innovations include a product that freezes the price of electricity for a set contract period; and smoothed payment plans. We were told that these types of products have been developed in response to customers concerns about the cost of living. Some retailers are moving towards more service offerings such as online portals in order to meet customer demands and to remain competitive in the market.

We were told by most retailers that they do not necessarily discriminate their retailing activity by location. Small retailers, however, do seem to take into consideration commercial factors such as the regulated tariff that applies in each area and, at a more micro level, the credit worthiness of customers in particular areas.

### **Retailer rivalry in gas**

Retailer rivalry in gas is rated lower than in electricity. Several respondents said that, unlike electricity, gas is not a primary fuel in NSW. Penetration rates and consumption levels are lower than for electricity and this is one reason why there may be less competition for gas customers. That is, there are fewer gas retailers competing for customers and therefore rivalry for customers may be lower.

New entrants consider that of the two markets, the gas market is harder to enter than the electricity market. The reasons for this are attributed to the complexities of the gas market structure and other arrangements.

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<sup>2</sup> IPART 2012, *Review of regulated retail prices and charges for electricity 2013 to 2016 Electricity Issues Paper*, November 2012, p.25.

<sup>3</sup> Note that while AGL is not an electricity incumbent in NSW, we do not include AGL within our meaning of ‘new entrant’.

## **Awareness and responsiveness of customers**

The general view is that the level of customer awareness in NSW about the ability to switch retailers (and contracts) is reasonable to high. Respondents consistently referred to an increase in NSW consumer awareness in the past two years as a result of recent increases in electricity prices; greater attention from traditional media about price increases; the One Big Switch campaign; and the privatisation of the NSW State-owned retailers. Further, an increase in retailers actively door knocking and telemarketing is seen to be contributing to making more customers aware of the ability to switch.

Electricity is considered a 'low involvement' product in that customers have low levels of initiative to seek competitive offers. There is, however, a trend for customers to increasingly research and switch online. This is viewed by respondents as a sign that customers are becoming more aware and engaged in the competitive market.

The main barrier for customer switching is considered to be customer inertia or apathy – the “why bother?” and “what’s in it for me?” type factors. Several retailers suggested that public education campaigns about retail competition are needed to reach customers that new entrant retailers have difficulty reaching through door knocking. These types of customers include those living in secure apartment blocks and/or those who work during the day when door knocking occurs.

Customer awareness about the ability to switch in gas is considered to be around the same or slightly lower. One reason given as to why it may be lower is that there are fewer gas retailers (or dual fuel retailers) in the market compared to electricity retailers. Therefore customers may be less informed about retail gas competition because they receive fewer gas or dual offers. Willingness of customers to switch, however, is considered to be the same as electricity.

## **Structural and regulatory barriers in electricity**

### **Barriers created by retail price regulation**

Lower headroom in electricity prices in NSW is considered to be inhibiting new entrant retailers from being as active in the NSW market as they would like to be. This is borne out by the size of the new entrant retailers. Several of the new entrant retailers we spoke to have customer numbers in the hundreds of thousands in the Victorian market but only in the tens of thousands in NSW.

Two active retailers have curtailed their retailing activities in the Ausgrid area following the Independent Pricing and Regulatory Tribunal’s (IPART) regulated electricity retail price determination applying from 1 July 2012.<sup>4</sup> We were told that insufficient headroom in the 2012 determination has acted as a barrier to expansion for these retailers. Further, at least two inactive retailers said that price regulation and the uncertainty that it creates has curtailed entry into the NSW market and so acted as a barrier to entry.

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<sup>4</sup> IPART 2012, *Changes in regulated electricity retail prices from 1 July 2012 Electricity -Determination*, June 2012.

### **Extent of barriers to wholesale electricity**

Several of the new entrant retailers consider obtaining wholesale cover in NSW to be challenging, especially when compared to Victoria. The NSW generation sector is viewed as a far less proactive generation market than Victoria. The respondents consider that this issue may be resolved with the proposed privatisation of the NSW Government-owned generators. Some small retailers do have concerns, depending on who purchases the generation assets, about increased concentration in the NSW generation sector.

### **Market prudential requirements and network credit support**

Several of the smaller retailers said that the market prudential requirements represent a significant barrier to small new entrant retailers. The NSW network credit support requirements are considered to be an impediment to expansion. The NSW arrangements, however, will be replaced under the National Energy Customer Framework (NECF) arrangements. It is considered that the network credit support requirements under NECF will improve retail expansion conditions for smaller retailers. NECF is scheduled to be implemented in NSW on 1 July 2013.

### **Other regulatory arrangements**

The postponement of the introduction of NECF in NSW (from 1 July 2012 to 1 July 2013) was cited as a significant barrier to entry for several of the inactive and new entrant retailers. The common view is that the postponement of the introduction of NECF has resulted in higher costs for new entrant retailers seeking to enter a new jurisdiction such as NSW. The introduction of the NECF will standardise regulatory requirements and reduce costs for retailers operating in multiple jurisdictions.

Several retailers raised the issue of state-based regulatory and licensing requirements as a barrier to expansion in NSW. Retailers consider the divergence of environmental schemes across the jurisdictions increases the cost and complexity of operating in multiple jurisdictions. Two of the new entrant retailers said that the NSW requirement to offer green power to enquiring customers is a hurdle for them.

### **Economies of scale and vertical integration**

Respondents recognise that there are fairly strong economies of scale in energy retailing. The importance of economies of scale largely depends on the type of business model adopted by the retailer. The big retailers consider size and economies of scale to be important for their businesses. Small retailers said that they can access economies of scale by outsourcing services. For example, retailers can obtain local and overseas billing systems that are outsourced and fully serviced. Outsourcing services is cost effective for small retailers.

The respondents presented mixed views about the importance of vertical integration. The views ranged from vertical integration being hugely important to not at all necessary, and again depended on the retailer's business model. Several vertically integrated retailers commented that ownership of physical assets forms part of a risk management strategy. At least two retailers that are aligned with generation assets pointed out that they do not purchase electricity hedges from their aligned assets. At least three of the new entrant retailers that do not have any generation interests do not consider vertical integration to be important.

## **Structural and regulatory barriers in gas**

Gas retailing is generally considered to be a more complex business for new and small entrants. The reasons for this range from market structure issues, access to upstream gas, wholesale trading arrangements, and the complexity associated with organising access arrangements with gas pipelines and networks.

Retailers that do not retail gas consider that not having dual fuel is not necessarily an impediment because not all customers in NSW are connected to gas. There are indications, however, that dual fuel may be starting to become more important for retaining customers that are connected to gas.

Three of the new entrant retailers that do not retail gas in NSW and target business customers consider that not having gas is not necessarily an impediment. However, the view was expressed that dual fuel may be useful to win a few extra customers.

## **Product offers and marketing**

### **Market offers**

The big three retailers have a suite of products and services on offer in the market. The smaller retailers are more likely to have one or two products and services that they offer in the market as a point of differentiation from other retailers. Some of the new entrant retailers that focus only on the business customer segment offer account management services.

The extent of product innovation in NSW is considered to be low and based mostly on price, discounts and cash rebates. Retailer discount offers are presented as a discount off the regulated tariffs. The existence of pricing regulation in NSW is considered to stifle product innovation in comparison to Victoria where prices are deregulated.

Retailers said they are increasingly responding to customer demands for new services. The types of innovations referred to include fixed price contracts and services that provide information to customers about their energy consumption, managing energy use and managing their bills. The entry into NSW of new retailers offering energy management services is a sign of the market responding to customer demands.

Gas is not generally offered on a stand-alone basis unless a customer requests it. Gas, for the most part, is attached to an electricity offer as part of a dual fuel product offering. Respondents noted that retailers are increasingly bundling electricity and gas. Also, some retailers are starting to bundle energy with other services such as telecommunications and insurance.

### **Marketing activities**

The most popular marketing channels for retailers who focus on the residential market are door knocking and telesales. There is also an increase in the importance of online channels. The retailers all have an online presence and most advertise their product and service offers online.

Door knocking is important to many of the interviewed retailers. Any ban on door knocking will be, in the view of the small retailers, detrimental to competition. As evidence of this

view, several respondents referred to the UK where a ban on door knocking has resulted in falls in customer switching rates and increases in the profits of the big retailers.

We were told that a scheme initiated by the ERAA, Energy Assurance Limited, monitors door knocking and has assisted in reducing the number of customer complaints in the industry.

## **Prices and profitability**

There is a distinction between the views of the incumbent retailers, who are subject to price regulation, and the other respondents we spoke to. The four incumbent retailers who are subject to price regulation in either or both electricity and gas seem to consider that the current levels of prices in the NSW electricity and gas markets are reasonable.

The small retailers operating in the market are less sanguine and do not consider the level of profitability in the markets to be healthy. The main point of concern is that new entrants are competing against a ‘theoretical efficient price’ and that this conceptual underpinning is not the price that will encourage entry and competition in the market.

NSW is not considered to be a particularly profitable market at the moment. Future plans for some of the new entrant and inactive retailers largely depend on the outcomes of IPART’s review of regulated electricity retail tariffs and charges which will apply from 1 July 2013 to 30 June 2016.<sup>5</sup>

## **Future market developments**

### **Options for deregulation and continued regulation**

The majority of respondents strongly support the deregulation of electricity prices of ‘Standard Retailers’ (referred to in this report as ‘incumbents’) for customers who remain on standard form customer contracts. Many of these respondents expressed support for the NSW Government to emulate the staged approach to deregulating prices adopted in Victoria in 2009. The Victorian approach is considered to have merit because the transitional implementation process went smoothly and is a proven model. Several other retailers consider that the NSW Government should simply remove price regulation in one go without a transition period.

There is support for reducing the definition of small customers to a lower threshold as a way to transition to full price deregulation. A number of respondents consider that the threshold of 100 MWh per annum (referred to the terms of reference for IPART electricity prices review) is still too high given that the average consumption level for residential customers in NSW is around 7 MWh per annum.

If price regulation is to be retained, there is a consistent view that a more light handed approach is preferable to the heavy handed form of regulation that is currently in place in NSW. Light handed forms of regulation that were mentioned included price monitoring type approach or voluntary arrangements.

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<sup>5</sup> Information about IPART’s review can be found at <http://www.ipart.nsw.gov.au/Home/Industries/Electricity/Reviews>.

### **Ten years from now**

New technology is seen as a game changer in the energy sector and will influence the way the market operates in the future.

Quite a few of the respondents said that the traditional model of energy retailing is on the wane. These respondents see new types of businesses emerging that will offer energy services of a more integrated type. We heard from several retailers that their role in the future will be to help customers with energy management and their business will become a whole of energy service provider.





# 1. Introduction

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## 1.1 Background

### 1.1.1 Purpose and objectives of the project

The Australian Energy Market Commission (AEMC) is conducting a review into the effectiveness of competition in the small customer electricity and natural gas retail markets in NSW (NSW Review). The AEMC conducted similar reviews in Victoria (2007), South Australia (2008) and the ACT (2010).

As in previous reviews, the AEMC considers energy retailers to be an important source of information for the retail competition reviews. To help inform the NSW Review, the AEMC commissioned Sapere Research Group (Sapere) to conduct interviews with retailers that are licensed to operate in NSW and with the Energy Retailers Association of Australia (ERAA) and the Energy Supply Association of Australia (ESAA).

The purpose of the interviews was to gather retailer and industry association views on a broad range of topics relevant to assessing the state of competition in NSW retail energy markets.

The key topics in the interviews included:

- perceptions of competitiveness in the NSW small customer electricity and natural gas retail markets - including the extent of retailer rivalry, marketing activities and customer awareness and willingness to engage in the market
- barriers and impediments to entering, expanding or exiting the NSW market
- options for removing or retaining retail price controls small customers in NSW.

### 1.1.2 Approach to the interviews

The AEMC provided us with a list of potential interviewees that included retailers licensed to operate in the NSW electricity and gas markets and the ERAA and ESAA. The list included 20 retailers.

Of the 20 retailers we contacted, 16 agreed to participate in the interviews. One of the retailers, PowerDirect is owned by AGL and was not interviewed separately. In total we interviewed 18 organisations, including the ERAA and ESAA. The representatives from the retailers that participated in the interviews included the chief executive officers of several of the new entrant retailers, retail and marketing executives, and regulatory managers. The interviews were conducted between 28 November and 18 December 2012.<sup>6</sup>

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<sup>6</sup> The retailer interviews conducted by Sapere commenced prior to the AEMC formally commencing the NSW Review.

The following table is a list of the retailers provided to Sapere by the AEMC. We have shown the contacted retailers according to whether they are active or not active in NSW.

**Table 1 NSW licensed energy retailers contacted for an interview**

	Active in NSW	Not active in NSW
<b>Electricity</b>	ActewAGL AGL (owns Powerdirect) Australian Power and Gas Dodo Power and Gas EnergyAustralia ERM Power GoEnergy Lumo Momentum Origin Energy QEnergy Red Energy Sanctuary Energy Simply Energy.	Alinta Aurora Energy BlueNRG Click Energy Diamond
<b>Gas</b>	ActewAGL AGL Australian Power and Gas EnergyAustralia Lumo Origin Energy	Alinta Aurora Energy Dodo Power and Gas GoEnergy Simply Energy

The interviews involved:

- Direct interviews with Sapere personnel and retailer representatives that were either face-to-face, over the phone and/or via video conferencing. The majority of interviews were face-to-face. The comments made in the interviews have been treated as confidential and provided to the AEMC only.
- Recording of the interviews with the permission of interviewees.
- Transcription of the recorded interviews.

Our approach to the interviews was to prepare a list of questions that covered a range of topics consistent with the criteria developed by the Ministerial Council on Energy (MCE) for the competition reviews,<sup>7</sup> specific questions about time-of-use pricing, and options for the removal or retention of pricing regulation. The questions cover electricity and gas retailing and are customised for retailers that are active as well as inactive in the NSW market. The questionnaire for the interviews with the ERAA and the ESAA included a slightly different set of questions.

<sup>7</sup> The MCE criteria are discussed in the AEMC's *Statement of Approach* which can be found at <http://www.aemc.gov.au/Market-Reviews/Open/nsw-retail-competition-review>

The list of questions for the NSW Review is set out in an attachment to this report. The list of questions was used as a guide and the issues covered were adapted in response to the issues most relevant to the respondents.

In the course of the interviews, we agreed with the retailers and the associations to maintain confidentiality of information discussed in the interviews. Where respondents are quoted in this report we have not made reference to the specific person or organisation.

This report is a compilation of the views and perceptions of the retailers and associations ('respondents') that we interviewed. In preparing the report we sought to encapsulate the range of views expressed in the interviews while at the same time looking for similar themes as well as unique perspectives. In particular, we looked for similarities in themes between incumbent retailers (sometimes referred to as 'first tier' retailers) and new entrant retailers (sometimes referred to 'second tier' retailers). We use the term 'big three' retailers when referring to AGL, EnergyAustralia and Origin Energy. For simplicity, and to avoid inadvertently identifying individual retailers, we refer to the remaining retailers as 'small retailers'. We use quotations from the interviews that clearly articulate an important point made by a respondent.

This report compiles information from over 600 pages of transcripts and around 30 hours of interviews into a format that provides the AEMC with the relevant information to be incorporated into the economic analysis to be undertaken for the NSW Review.

In our view, the respondents who participated in the interviews provided thoughtful, informative and candid responses to our questions. We certainly appreciate the time and effort extended by the respondents.

## 1.2 Report structure

The structure of this report is as follows:

- Chapter 2 provides an overview of the licensed electricity and gas retailers that participated in the interviews.
- Chapter 3 presents an overview of the thoughts on competitiveness in NSW.
- Chapter 4 presents perceptions about the level and extent of retailer rivalry.
- Chapter 5 contains perceptions about customer awareness of competition.
- Chapter 6 compiles views about barriers to entry, expansion and exiting the market.
- Chapter 7 looks at retailers' product and service offerings together with their marketing activities.
- Chapter 8 presents views about prices and profitability.
- Chapter 9 sets out the views about future market developments including a look at regulatory arrangements.

The appendices to this report contain information about the retailers contacted for this project and the list of questions for the interviews.



## 2. Overview of participating retailers

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In conducting the interviews, we firstly asked retailers to provide an overview of their retailing activities. We were interested in finding out whether they have an electricity licence and/or a gas licence; whether they are active in the NSW market or not. We asked about their activities in other jurisdictions to get an understanding of the importance of a national retailing presence, and the extent to which the business was vertically integrated through ownership of generation assets or gas assets.

We asked retailers to comment on whether there are any differences in the way they operate in NSW compared to other jurisdictions. We concluded this set of questions by asking retailers to outline, in general, their planned future activities in the NSW market.

The objective of this set of questions is to provide operational context to the responses of the retailers regarding the competitiveness of the NSW market and the types of marketing activities undertaken.

### 2.1 Electricity retailers interviewed

#### 2.1.1 Active and non-active retailers

For the purposes of this report, we use the term ‘active’ to describe retailers that have a customer base in NSW and are actively ‘marketing’ to gain new customers. We use the term ‘inactive’ to describe retailers that have an electricity licence but that do not have a customer base in NSW and are not actively seeking customers at this stage.

The 16 retailers interviewed as part of this review all hold an electricity licence in NSW. Of this sample group, 13 are active in the NSW market.

In this group of 13 active retailers, 11 are actively retailing to residential and small business customers. There is a total of nine retailers retailing to residential customers. Three of these retailers are focused on the residential customer segment only. There is a total of eight retailers that retail to small business customers. Two of these retailers target business customers only.

A further two of the retailers we spoke to specialise in retailing to medium to large business customers including the Commercial and Industrial (C&I) customer market segment.

Two of the retailers that focus on business customers are very new entrants having entered the market in the latter half of 2012. Two retailers indicated that they are considering entering the Small and Medium Enterprise (SME) market in the near future.

All of the active retailers hold electricity licences in other jurisdictions. All but one holds an electricity licence in more than two jurisdictions (including NSW). Most of the retailers are active in other jurisdictions and particularly in Victoria.

A new development is the emergence of retailers that offer energy services in addition to retailing. The product offers include energy management services to customers and the installation of solar panels at customer premises combined with a retail contract.

One of the retailers also maintains retail outlets as part of its retail business. The retail outlets sell household electrical and gas appliances.

## 2.1.2 Vertical integration with generation

In total, nine of the active retailers are aligned to some degree with generation interests. The big three electricity retailers are vertically integrated. All three own electricity generation assets in various states in the national electricity market (NEM).<sup>8</sup> Two of the big retailers have ‘gentrader’ rights for the output of a number of the NSW State-owned generators. At least two of the big retailers said that their generation interests do not fully match their NSW customer bases and that they purchase wholesale electricity from the market (that is, from generation sources they do not own).

Six other active small retailers either own generation assets or are owned by generation interests. Three of the small active retailers are owned by generation businesses. At least two of these retailers said they do not obtain generation from the assets with which they have ownership alignment. At least one of the small retailers owns a small amount of peaking generation plant.

Several of the small retailers said they have concerns about the outcomes of the NSW Government’s planned sale of State-owned electricity generation assets. They consider that the outcomes of the planned privatisation of the NSW State-owned generators may affect liquidity in the market depending on who buys the generators.

## 2.1.3 Operational differences in NSW

We asked retailers whether there are any differences in the way they operate in NSW compared to other states. The most common response was that there are no real differences. Most retailers said that they offer the same sorts of products and services in each jurisdiction.

The main difference noted by a number of respondents is that the privatisation of the State-owned electricity retailers has improved conditions for operating in NSW. For example, we were told that since the privatisation of the NSW State-owned electricity retailers more customers are moving from regulated to market contracts. Other retailers said that the removal of government ownership of the retailers has removed schemes that involved some forms of cross-subsidisation in the market.

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<sup>8</sup> The NEM is a physically interconnected power system and wholesale generation spot market operated by the Australian Energy Market Operator (AEMO). High voltage transmission lines interconnect the regions of NSW, Queensland, Victoria, ACT, South Australia and Tasmania. AEMO operates the wholesale spot market to ensure sufficient generation is dispatched to meet system demand. Scheduled generators submit bids to AEMO and compete to be dispatched. The wholesale spot market arrangements are underpinned by financial hedging arrangements to limit exposure by the generators and retailers to the fluctuations of spot market prices. For more information, see <http://www.aemo.com.au/About-the-Industry/Energy-Markets/National-Electricity-Market>

The following comment was made by one of the respondents:

*What has been different over the last couple of years is that there was a far lower amount of customers that were on market contracts in New South Wales because, ... where the government was heavily involved in retail and the like, it was very difficult because of a number of schemes in the background that had some forms of cross-subsidisation. That doesn't exist anymore. When that was taken away and the retail market was privatised, that market now functions as competitively as pretty well any other market in the country.*

Another retailer commented that small business customers in NSW are more willing to churn<sup>9</sup> than in South Australia. This retailer considers that NSW business customers are very focused on the price of electricity.

## 2.1.4 Future plans

In general, all of the active retailers are committed to the NSW market. New entrant retailers are looking to expand their NSW customer base. The view of one small retailer is that the Victorian market is probably reaching saturation point. As such, NSW is seen as a market for retailers to expand into. While NSW is not considered to be a particularly profitable market at the moment, entry seems to be based on a long term view of the attractiveness of the NSW market.

One retailer said:

*But [new entrants have] shown that they're actually in the market competing because they see it as an attractive long-term market obviously.<sup>10</sup>*

One of the small retailers said that, while it may not become a major market changer in terms of market share, from a 'second tier' point of view it will be relevant in the NSW marketplace. This view is based on a strategy to operate on a profitable basis in NSW and optimise returns for its shareholder.

One inactive retailer described its situation with regards to its future plans for NSW as "sitting on the edge". This retailer, and several other small retailers, indicated that they are very focused on the outcomes of the forthcoming 2013 IPART electricity pricing determination. The outcomes will affect their future activities in NSW. Several of the small retailers expressed cautious optimism about the outcomes of the 2013 IPART pricing determination. It was noted that IPART is likely to be more focused on encouraging competition in light of the terms of reference for the electricity pricing review. The terms of reference refer to the continuation of pricing regulation being underpinned by the principle of enhancing competition.<sup>11</sup>

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<sup>9</sup> For the purposes of this report the term 'churn' refers to customers switching between competing retailers. It does not refer to customers switching between standing (regulated) offers and market contracts with the same retailer.

<sup>10</sup> For this and all other quotations in this report the text in parentheses has been added to help clarify the meaning of the quotation.

<sup>11</sup> IPART is responsible for regulating electricity prices of 'Standard Retailers' (referred to in this report as 'incumbents') to small retail customers who remain on standard form customer contracts. The current

## 2.2 Gas retailers interviewed

### 2.2.1 Active and non-active retailers

Ten of the interviewed retailers hold a gas licence. These retailers all hold an electricity licence - no retailer holds a gas licence without holding an electricity licence. Two of the interviewed gas retailers are in a joint venture arrangement and retailing activities are carried out under different brands in different regions.

Of the ten licensed retailers, six are actively retailing gas in NSW. Five other retailers have gas licences but are not active in the market. One retailer is giving consideration to gas retailing in the future. Another retailer is considering selling gas to small business customers in the near future.

Another active electricity retailer that did not have a gas licence is contemplating obtaining a licence at some time in the future.

At least two electricity retailers said they are not intending to enter the gas market. One in particular said that its particular strength is in retailing electricity to the small to medium business market. In particular, smaller electricity retailers said they do not have the resources to contemplate entering the gas market. The business models of the respective retailers are focused on electricity only.

At least one of the new entrant retailers is heavily focussed on a dual fuel capability.

### 2.2.2 Vertical integration with upstream gas

Of the retailers interviewed that are active in gas, three have upstream gas interests across Australia. These there are the big three retailers. None of the small retailers have upstream gas interests.

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determination on these prices will expire on 30 June 2013. The NSW Minister for Resources and Energy has asked IPART to review and determine the regulated retail electricity prices and charges that will apply from 1 July 2013 to 30 June 2016. The terms of reference for the IPART *Review of regulated electricity retail tariffs and charges 2013 to 2016* can be found at:

[http://www.ipart.nsw.gov.au/Home/Industries/Electricity/Reviews/Retail\\_Pricing/Review\\_of\\_regulated\\_electricity\\_retail\\_tariffs\\_and\\_charges\\_2013\\_to\\_2016](http://www.ipart.nsw.gov.au/Home/Industries/Electricity/Reviews/Retail_Pricing/Review_of_regulated_electricity_retail_tariffs_and_charges_2013_to_2016)



## 3. Views on competitiveness of the NSW market

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Before going into more detailed questions about aspects of competition, we asked the respondents to describe the nature of competition in NSW including retailing activity and customer responsiveness. We were interested in respondent's general perceptions about the level and intensity of competition in the electricity and gas markets. For the newer entrants, we asked whether their corporate expectations about market share have been met. We also asked respondents to provide any observations about changes in the nature of competition since they have been in the market and, in particular, any changes since the sale of the three State-owned retailers to TruEnergy (now EnergyAustralia) and Origin Energy.

As background it should be noted that the three largest retailers, AGL, EnergyAustralia and Origin Energy have a market share of around 95 per cent of small electricity customers<sup>12</sup> and 98 per cent of residential gas customers.<sup>13</sup>

### 3.1 Nature of competition

#### 3.1.1 Views of NSW competitiveness

The majority of respondents consider NSW retail energy markets to be very competitive. This view is based on the activities of the retailers and the receptiveness of customers. Some of the words used to describe the nature of competition included “highly competitive”, “strong and healthy”, “grown significantly”, “intense”, and “more competitive than two years ago”.

Several retailers said that customers in NSW are very receptive to competition. There is a view amongst respondents that the recent electricity price increases and the introduction of a carbon price have resulted in increased customer interest in their energy bills. In turn, customers are more willing to switch from their existing contract to a more competitive one. In particular, the point was made that NSW customers have faced the highest electricity prices in recent years and this has prompted increased customer engagement in the retail electricity market.

It was noted that NSW customers are becoming more savvy and interested. One respondent said:

*...you've got increasingly savvy customers who are just interested in shopping around, so customers get better at being involved in the competitive market, so perhaps they're learning*

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<sup>12</sup> IPART 2012, *Review of regulated retail prices and charges for electricity 2013 to 2016 Electricity Issues Paper*, November 2012, p.25.

<sup>13</sup> AEMC 2012, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales, Issues Paper*, December 2012, p.22.

*to be a bit more involved and they're understanding now there are better deals on the table for them, if they shop around.*

More than half of the respondents said that the level of competition in NSW has increased, particularly in the last two years. To support this view, retailers pointed out a number of factors where competition has intensified.

First, several retailers referred to the churn rates in NSW as evidence of competitiveness. The electricity market is seeing churn rates of 20 per cent for electricity and 15 per cent for gas. (One retailer explained that the churn figure for gas is lower because the penetration of gas is lower: whilst all households are connected to electricity, not all households have gas connections).

Second, retailers also noted that an increasing numbers of customers are moving from regulated contracts to market contracts (which are not counted as switches if there is no change of retailer). However, no quantitative evidence was provided to us to support these suggestions.

Third, several respondents remarked that there has been a marked increase in the level of door knocking activity in NSW. Within the industry, a number of retailers consider that a leading indicator in the level of competition is door knocking activity.

Fourth, several respondents said that there has been an increase in the level of price discounts being offered and further that retailers are more aggressive about making counter offers to retain existing customers.

Other factors cited as contributing to greater competition includes the success of the "One Big Switch" campaign. This campaign was referred to by several respondents as having significantly raised customer awareness about retail competition.

Four retailers commented that, since the privatisation of the NSW State-owned retailers, much of the competition is being driven by the three large retailers AGL, EnergyAustralia and Origin Energy. Further, the big three retailers are engaging in more 'above the line' marketing such as television and radio advertising to increase their brand awareness.

Several of the new entrant retailers are specifically focused on business customers (from small to large). We got the impression from our discussions with these retailers that, while intense, the level of intensity in the business segment is less than in the residential segment. It is interesting to note that two of the newest entrants in the NSW market are focusing on retailing to business customers.

We asked each active retailer who they consider to be their main competitors. Each retailer readily named several other retailers. On the basis of responses given, our impression is that there is between six and nine retailers actively competing at any one time. When we asked respondents whether the new entrant retailers are likely to make more of an impact in the NSW market, one of the large retailers commented that the new entrants are active and they are noticeable. Other small retailers said that they will be seeking to grow on a financially sustainable basis in NSW.

### 3.1.2 NSW is competitive, but...

We asked new entrant retailers whether their expectations about winning customers in NSW are being met. Several of the new entrants responded positively. One of the new entrant retailers was less sanguine. This retailer said that it had started selling to customers a few years ago but that it stopped actively competing for new customers in the Ausgrid area following the IPART electricity pricing determination that applied from 1 July 2012. It said that the prices in the 2012 IPART electricity pricing determination that applied in the Ausgrid area created commercial restrictions which affected the achievement of what it viewed as its natural position in the NSW market. The 2012 IPART electricity pricing determination resulted in a set back to its customer acquisition strategy in NSW. A second new entrant retailer also said that it had stopped retailing in the Ausgrid area for similar reasons.

Another new entrant retailer said that over the last 12 months it has been able to build its brand quite significantly. It added that the reason for this is because it is backed up by generation assets.

One of the larger retailers commented that the level of churn in the NSW market today was higher than it originally had anticipated. Two of the incumbent gas retailers said that they have suffered a decline in their market share.

One of the inactive retailers said it does not consider the NSW electricity market to be competitive. This retailer expressed frustration about the NSW market on a number of fronts, including the extent of competition between retailers, wholesale market arrangements, and the extent of vertical integration. This retailer's view is that new entrant retailers have not made much of an impact in the NSW market and that competition is largely limited to activity amongst the three big retailers.

The comment was made that:

*...their [the big three retailers] plan is simply to shuffle consumers around until they reach a retention position that they're happy with.*

This retailer's perspective of the NSW market is influenced by its negative view about the wholesale arrangements in NSW. In particular, the retailer referred to the wholesale purchasing arrangements made by the NSW Government between State-owned generators and the two of the large retailers. This retailer is concerned at the level of vertical integration that has been allowed to occur in the NSW by the Government and the Australian Competition and Consumer Commission (ACCC).

#### **... not as competitive as Victoria**

While respondents view NSW to be a competitive market, they view it as being less competitive than Victoria. Amongst the retailers operating in both NSW and Victoria, Victoria is considered to be the benchmark in terms of competitive markets.

The reasons why Victoria is viewed as being more competitive include:

- a higher level of churn in Victoria than NSW
- a fully privatised market
- the removal of pricing regulation.

In general, respondents consider that these factors allow for the electricity prices to be set by the market and without regulatory intervention. The respondents consider that the removal of price regulation in Victorian as removed an element of risk and uncertainty from the market.

An example of this view was expressed by one retailer as follows:

*And for the last four years, Victoria has been the most competitive market in the world, as measured by customers churning, and there [are] a number of reasons for that. There is a fully privatised market, price deregulation and – so price deregulation has implemented a lot more innovation, a lot less risk to operate in the market and hence we see all sort of variable discounting going on pricing as well. So it's just got a couple of extra characteristics which just tweak that a little bit more.*

Several respondents expressed the view that new entrant retailers have not yet made much impact in NSW. One respondent maintained that a leading indicator of competitiveness in a market is the level of activity of new entrant retailers. This retailer observed that the activity of second tier retailers in NSW is somewhat muted especially in comparison to Victoria: The reason given for the lack of activity by new entrants is the lack of profitability in NSW.

This retailer said:

*You would think the lead indicator [of competitiveness] would be how active are the second-tier companies, because [NSW is] not a market that seems to have attracted a whole lot of new entrants, as Victoria did. And so, therefore, literally is it highly competitive? Absolutely. There is a lot of churn there, there's a lot of transfer of customers. But is it a profitable, attractive market? Probably not. You know, because the activity of the second tiers is a little bit muted.*

The difference in the success of new entrants in NSW compared to Victoria emerged as a key theme during the course of the interviews. As background, during the AEMC's 2007 review of the effectiveness of competition in Victoria, the market share of new entrant retailers in electricity was found to be around 20 per cent.<sup>14</sup> In contrast, the market share of new entrants in the NSW electricity market is currently around 5 per cent.<sup>15</sup> This led to us to ask respondents to consider the reasons why new entrant retailers have had less of an impact in NSW compared to in Victoria.

Several respondents said that competition in NSW is lower than in Victoria because price regulation and, in particular, the lack of 'headroom' in regulated prices have hampered competition in NSW. The responses reveal that, lower regulated margins in NSW are perceived to be less attractive for new entrants in NSW relative to Victoria.

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<sup>14</sup> AEMC 2007, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria, First Final Report*, 19 December 2007, p.34.

<sup>15</sup> IPART 2012, *Review of regulated retail prices and charges for electricity 2013 to 2016 Electricity Issues Paper*, November 2012, p.25.

One respondent commented that:

*Back in that 2007 to 2010 period the margins were much more attractive in Victoria than they would have been in NSW - when the [NSW] regulatory decision was clamping against a high wholesale price. And if you're running a retail business you would dedicate your resources to chasing customers in Victoria where you could capture a higher margin.*

Another retailer explained that the low retail margins in NSW take the break-even point (the point when a business becomes profitable) to beyond three years. A break-even point of beyond three years is considered by this retailer to be unattractive for a new entrant, and especially for absolute new entrant that did not already have a customer base in another jurisdiction.

This retailer said:

*...I think even as a start-up in Victoria you're looking at the best part of three years to break even, you know, to start becoming cash-flow positive. So I would say the break-even point [in NSW] would be beyond the two to three year mark, well beyond that, which would make it unattractive for an absolute new entrant.*

Further, one respondent noted that the NSW Government's (now defunct) Electricity Tariff Equalisation Fund<sup>16</sup> (ETEF) provided an incentive for Government-owned retailers to migrate customers from market contracts back to regulated tariffs during times of high wholesale electricity prices. According to this respondent, during the drought in 2007 wholesale prices increased markedly and it became more attractive for customers to be on regulated contracts rather than market contracts. The respondent said that there is evidence, based on IPART data, showing that regulated customer numbers (relative to market contract customers) started to increase in 2008 (at the time of high wholesale prices).

The inference is that this increase in regulated customer numbers was as a result of the interaction between the ETEF and wholesale electricity priced. The ETEF scheme was phased out between 2010 and 2011 but its 'legacy effect' of incentivising customers to be placed on regulated tariffs is perceived to be one of factors contributing to affecting the current state of retail competition in NSW.

Another inactive retailer, while acknowledging that competition did exist in NSW, expressed the view that this belief has been "shaken a bit in recent times". This upset was due to the recent pricing interventions in Queensland<sup>17</sup> and South Australia.<sup>18</sup> This retailer is preparing

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<sup>16</sup> The ETEF was a fund that standard retail suppliers (incumbents) were required to pay money into when pool prices were lower than the energy cost component they recovered from regulated customers. When pool prices were higher than the energy cost component in the regulated tariff, the ETEF made payments to standard retailers to enable them to purchase wholesale electricity for regulated customers and still earn a regulated margin. Refer to NSW Treasury 2000, *Electricity Tariff Equalisation Fund: Information Paper*, December 2000.

<sup>17</sup> A decision by the Queensland Government froze the standard electricity tariff (Tariff 11) for 12 months, starting on 1 July 2012. See <http://statements.qld.gov.au/Statement/Id/79051> for more information.

<sup>18</sup> The Essential Services Commission of SA (ESCOSA), made a Special Circumstances Determination and a Draft Price Determination in October 2012 which set out 8.1 per cent price reduction for electricity standing contract customers. This action by ESCOSA led to AGL applying the Supreme Court to prevent the ESCOSA from making a Final Price Determination. On 18 December, the South Australian Government

to enter the NSW market but as yet has not received Board approval to do so. Regulatory intervention and price regulation are upper most in the consideration about whether to enter the NSW market. These views are discussed further in section 6.1.

In summary, there is a clear difference in the experience of new entrants operating in NSW compared to Victoria. New entrant retailers have not made the same impact in NSW compared to Victoria. Much of this is attributed to the lack of headroom in the regulated prices in NSW compared to Victoria.

## 3.2 Impact of privatisation of State-owned retailers

There is a consistent view that the level of competition in the electricity market has stepped up and become more intense since the privatisation of the three NSW Government-owned retailers. One retailer described the privatisation event as a “catalyst for competition”.

To demonstrate this increase in competition perceived by most retailers, one of the respondents stated that prior to privatisation retailers were offering price discounts of around 7 per cent. Post privatisation, the discounts are more in the order of 15 per cent - more than double what was previously offered to consumers. Several retailers mentioned that they have recently seen offers by some of the big retailers of price discount up to 25 per cent off the electricity consumption component of their bill. This level of the price discounts was observed in all areas across NSW – urban, regional, and rural.

Further, six respondents consider that AGL in particular has been engaging in aggressive competitive behaviour as a way of gaining customers because that it had not purchased one of the incumbent State-owned retailers.

Several of the new entrant retailers questioned the long term financial sustainability some of the large discounts on offer in the market. One of the retailers mused whether the large discounts were perhaps linked to value through integration with gas or based on a long-term ‘promise’ of a customer base.

As said by this small retailer:

*We don't understand how they [the big retailers offering big discounts] can expect to make money based on the offers that they're making to customers.....or maybe they've got other value through integration of gas.*

Several retailers told us that the larger retailers have learned from their experience in Victoria that small retailers can be very competitive. Consequently, in NSW the big retailers are increasingly making counter-offers to customers. Several small retailers, including one that has a customer base in regional areas, said that they make offers to customers only to find that the original (big) retailer is making a counter offer to the approached customer. The

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announced a policy change regarding price regulation of retail energy prices. In light of this announcement, the ESCOSA suspended its wholesale electricity cost (WEC) review. Refer to <http://www.escosa.sa.gov.au/article/news>.

small retailers consider that the large retailers are engaging in aggressive retention strategy to prevent the loss of customers to another retailer. Another small retailer said that as a result of this type of behaviour from the large retailers it experiences a high cancellation rate from customers it has made an offer to. This small retailer said that it could not win back the customer as it cannot offer a more competitive contract than the counter-offer made by the competing big retailer.

## 4. Level and extent of retailer rivalry

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One of the six criteria the AEMC is required to consider is the extent of retailer rivalry in the electricity and gas markets. The extent of retailer rivalry can be gauged by a range of factors including number of retailers and the intensity of the rivalry for customers. Retailer activities such as products and services being offered, prices and other conditions of energy supply indicate the intensity of rivalry. We requested respondents to rate the level of rivalry (between 0 and 10).

Also, we were interested in finding out whether retailers have different attitudes towards or strategies in different regions – notably urban, regional and rural areas. We were interested in finding out the basis of rivalry (price versus non-price). These questions are a prelude to more detailed consideration of retailer marketing activities and products discussed in Chapter 7.

We asked respondents to consider these questions separately for the electricity and gas markets.

### 4.1 Retailer rivalry in electricity

#### 4.1.1 Rating retailer rivalry in electricity

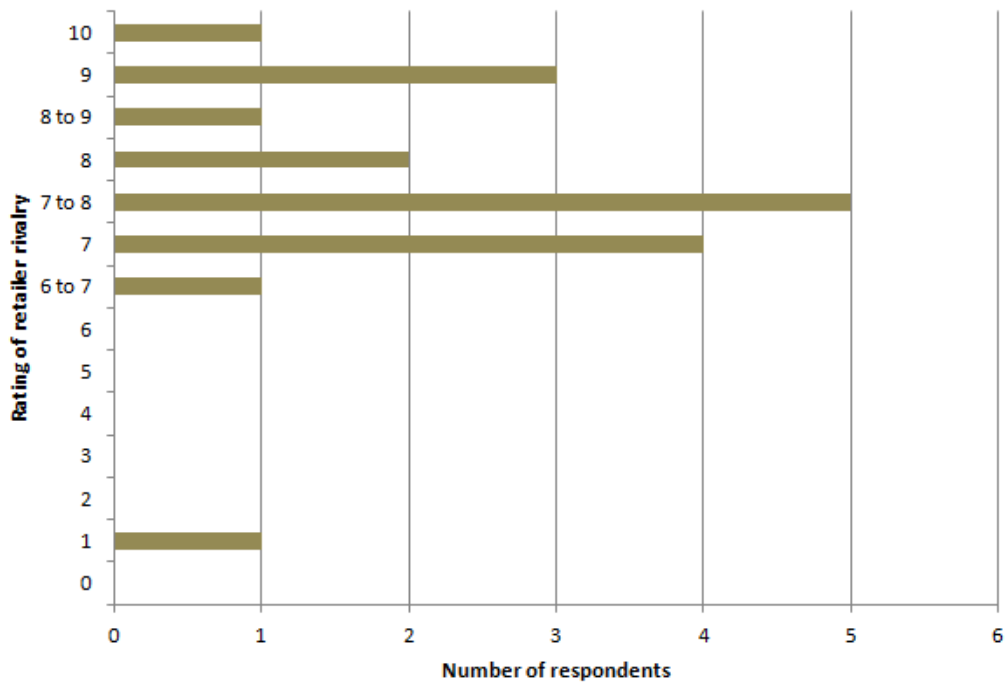
To gain an understanding of retailer rivalry in NSW, respondents were asked to rate on a scale of 0 to 10 (where 0 means not at all competitive and 10 means extremely competitive) how they would rate retailer rivalry for small customers in the NSW electricity market.

In answering this question, some retailers noted that it is difficult and arbitrary to assign a single figure rating to measure perceptions of retailer rivalry because there are several perspectives and matters to take into consideration. Nevertheless, a rating technique provides a useful starting point for more detailed discussions.

The ratings are shown in Figure 1, in order of rating from lowest to highest. Each bar represents the total number of respondents that ranked retailer rivalry at that particular level.



**Figure 1 Rating of retailer rivalry in electricity**



**Source:** Sapere analysis of retailer interview responses.

Figure 1 clearly demonstrates that most of the respondents consider the level of retailer rivalry to be high or very high. One retailer split its rating into 9 for the types of offers in the market and a 7 for the number of participants. For simplicity, we have counted the split ratings separately.

There are seven respondents that rated the level of retailer rivalry at 8 or greater (including the split rating for types of offers). Of the respondents that consider retailer rivalry to be 8 or more, the factors that influence this view are the:

- Increase in door knockers, telemarketers, and the biggest change was a lot of digital media and social media channels.
- Increase level of customer churn rates.
- Very aggressive competition from the two electricity incumbents EnergyAustralia and Origin Energy.
- High level of discounts being offered in the market by some retailers.
- Loss of market share experienced by some respondents.

The five respondents that gave a rating of around 7 to 8 (including the split rating) said that:

- While competition is considered to be high in NSW it is not as high as in Victoria.
- The level of churn has increased in the past 12 – 18 months but is not as high as in Victoria. The lower level of churn compared to Victoria marked down the rating for NSW.

- The three big retailers are fighting it out among themselves and this is driving a lot of the competition. One retailer suggested that the big three retailers are accounting for 75 per cent of the activity in the market.
- Large discounts being offered by the big retailers.
- A large number of active retailers competing in the market.
- Market share in NSW is more aggregated around the big three retailers which marked down the score.
- The second tiers have less of a market share than in Victoria. In Victoria there is a “much more even spread of the pie” in terms of second tier retailers winning customers. The NSW rivalry was marked down on this aspect.

In relation to the above points, one respondent said:

*[If Victoria was rated 10] Victoria for me is a function of the big guys and a lot of second tiers [that] are very active. Whereas in NSW a lesser (sic) number of second tiers are active but the big guys are very active.*

- The type of product propositions is not particularly innovative in NSW but it is improving. The types of improvements to innovations mentioned include fixed price products and offering customers access to their energy consumption information.
- The level of regulated prices in the Ausgrid area restricted competition in that area. The market could be more competitive if the Ausgrid area was not restricted due to the regulated prices.
- Profit levels are not particularly healthy and this lowered the rating for NSW.
- The prospect of price deregulation will retain the second tier retailers in the market and will attract new entrants.

The one respondent that rated retail activity at around 6 to 7 said:

- There are not as many players in NSW relative to Victoria. The lack of profit margin mutes activity by new entrants.
- The price increase is driving the customers to look around, not necessarily the advertising and the marketing activity by the retailers.
- There is less retention activity in NSW compared to Victoria.
- A lot of the activity is on the back of retailer activities in Victoria. Retailers see what works in Victoria and then copy it for the NSW market.

The one respondent that rated retailer rivalry at 1 said:

- It is not real competition.
- The three big retailers who have the wholesale purchasing deals as a result of the purchase of the generation output are offering large discounts and shuffling customers between themselves.

This exercise revealed a wide range of factors influencing retailers’ perceptions about the extent of retail rivalry. High ratings of retailer rivalry are based in observations of increased door knocking; the level of discounts on offer; and aggressive retention strategies. Much of this activity appears to be attributed to the big three retailers. There is a clear view that new

entrants are not as active in NSW compared to Victoria. The level of product innovation is considered to be low.

#### 4.1.2 Basis and extent of retailer rivalry

Respondents identified monetary factors, such as, price and discounts from the regulated tariff, as the key factors driving rivalry between retailers.

Several respondents explained that monetary factors are important because prices and the cost of living are uppermost in the minds of customers. One of the respondents explained the current sentiment of customers and the importance of price as follows:

*...price is a big one. The environment is there for that - there is a big cost of living focus, across the country at the moment. And that strikes a chord with energy pricing. So it's a natural fit and it makes a lot of sense that the price [is], centre of mind for many customers. We don't see a lot of evidence of differentiated service propositions being sold actively in the market.*

Two retailers said that they offer a product that freezes electricity prices for a set contract period. This type of product places the risk of any price increase onto the retailer rather than being passed onto customers. This product was described by the proponents as an innovation that was different to other products in the market and was developed in response to the cost of living concerns of customers.

The key retail offering is a reduction in the energy price to customers, or some other form of monetary incentive such as cash credits. One respondent explained its monetary offers as follows:

*...we offer, for example a \$100 fuel card, so the packaging of the price incentives is sometimes slightly different. Sometimes you get, like, 100 bucks upfront and 100 bucks for staying or that sort of thing, but, looks, it's pretty much all monetary*

One of the respondents opined that offers are driven by price in particular, because the regulated price sets a benchmark price and structure. Therefore, market offers tend to align as a discount off the regulated price.

Service-based offerings, such as providing good customer service, are seen as a way of retaining customers. Good customer service is considered to be an important factor for the larger business customers by a retailer that targeted these customers.

One retailer noted that one of the larger retailers was offering large cash credits to customers as a promotion in addition to a discount off the tariff. It was added that this retailer was probably taking a long-term view that one day it will get its money back on the product.

Several respondents noted that retailers are increasingly bundling electricity with gas (dual fuel) offers and some were starting to offer other services such as telecommunications and insurance policies.

Several retailers mentioned that they are starting to move away from just discounting to offering more innovative services as part of their offering to customers. Some retailers have or are developing online portals. The portals are being developed in Victoria where smart meters are being rolled out.

The reason for this shift in thinking away from discounting to more a service oriented approach is reflected in the following comment:

*...you can come into the market today and offer a discount but...thinking about sustainability, if you discount away your business then you then can't afford to service a customer. You can't afford to create innovation. You can't afford to give anything back.*

Several retailers said that they had loyalty programs as a way giving something back to customers.

Only two retailers, both small, said that brand awareness played a role in helping them to win and retail customers against less well known new entrants. Brand strength is reinforced through marketing and advertising spend, plus involvement in community sponsorship. Other small retailers said that they did not have the resources to engage in raising brand awareness in NSW.

### **4.1.3 Rivalry by location**

We posed the question about whether there are differences in the level of retailer activity in different regions. The main intention was to find out whether the level of retailer activity in regional and rural areas is any different from more densely populated cities, and whether effective competition is only present in specific areas.

One retailer explained that there probably is more competition in urban areas for logistical reasons. Because the majority of acquisitions occur door to door, the most competitive markets are within one hour's drive around the Sydney, Parramatta, Newcastle or Wollongong regions. It was explained that a retailer may be able to maintain a sales team in these urban areas. A retailer could not maintain a sales team in regional areas such as Dubbo or Wagga Wagga. Instead a retailer will send a sales team to work a regional area for a few weeks rather than maintain a permanent sales team. Similar comments were made by a big retailer who said that there was probably more activity in the urban areas due to easier access to customers. The frequency of contact with door knockers is probably lower in regional areas.

One of the large retailers expressed the view that since the privatisation of the NSW State-owned retailers, that there has been a big turnaround in the activity in regional areas. It said that based on its internal analysis, it has noticed a convergence between the level of customer churn in regional and urban areas in the last 12 to 18 months.

We were told that:

*I think up until privatisation there was probably a more noticeable difference [in rivalry in different locations] and there's been a big turnaround...over the last 12 – 18 months. Since [privatisation, there is] very little difference between...the city area compared to the country area which is a positive sign.*

This retailer added that in recent periods the churn rates in the Essential Energy (formerly Country Energy) have been greater than in other areas.

We were told by most retailers that they do not necessarily discriminate their retailing activity on a geographical basis. They do, however, take into consideration a variety of commercial factors before deciding whether to undertake a marketing campaign in a certain location.

The main driving factor influencing the location of where retailers target is whether they can make a profit on customers in the area in question taking into consideration the regulated price that applies in the area. An example of this commercial consideration is the decision by two small retailers that target the residential segment to cease retailing activities in the Ausgrid distribution area.

Another commercial factor influencing customer acquisition strategies is the credit rating of the customers. Two retailers mentioned that they would avoid areas where the risks of customer default, or non-payment of bills was greater.

We were also told that the behaviour of the incumbent in the area affected the level of retailer rivalry. This is shown by a comment made by one of the new entrants that targets small to medium business customers:

*It does make a difference who the incumbent is. As an observation, it's more difficult to penetrate in the [an incumbent retailer's] area...because..they do have fairly fierce retention offers out there.*

The new entrant retailers that target business customers consider the Ausgrid distribution area to be more attractive than other areas because of a higher number of businesses in the Ausgrid distribution area compared to other areas.

## 4.2 Retailer rivalry in gas

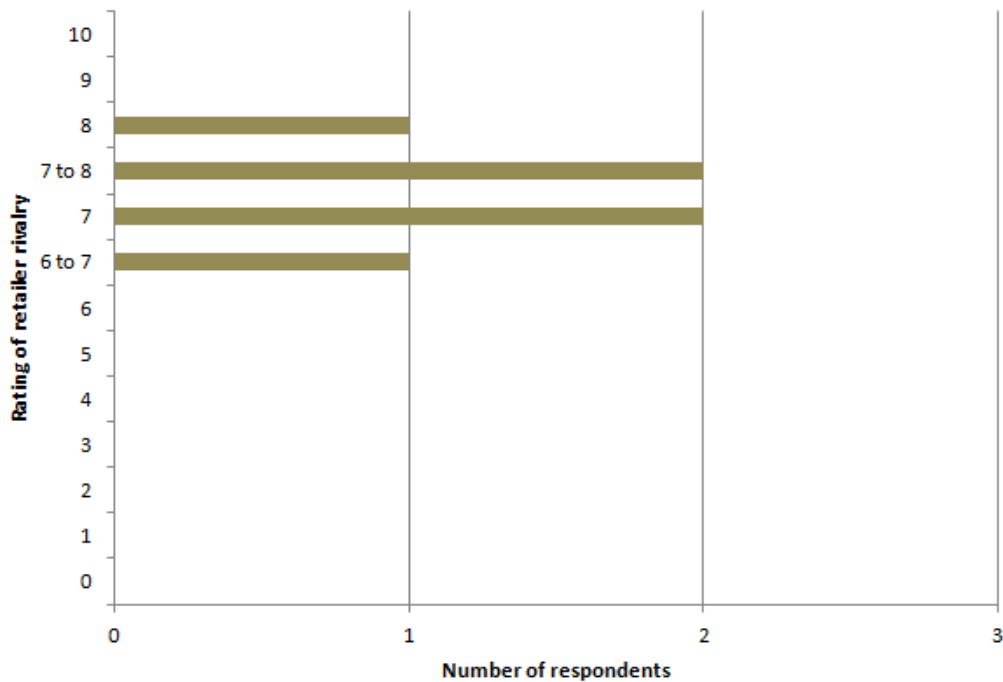
### 4.2.1 Rating retailer rivalry in gas

We were interested in finding out the views of retailers that were active and inactive in the gas market about the extent of retailer rivalry in the gas market. It was interesting for us to note that several of the inactive gas retailers did not feel in a position to talk about the gas market.

All retailers rated the level of rivalry in gas lower than electricity. Respondent ratings of the level of rivalry are shown in Figure 2 below.

We were told by most of the retailers that gas is not generally offered on a stand-alone basis unless a customer requests it. Gas offers are largely seen as a product that is attached to an electricity offer. That is, as a 'dual fuel' product offering.

**Figure 2 Rating of retailer rivalry in gas**



**Source:** Sapere analysis of retailer interview responses

Of the retailers we talked to about retail rivalry for gas customers, the general view is that the level of retailer rivalry for gas customers is lower than for electricity customers. The view presented by several respondents is that some retailers are less comfortable with the gas market because it is more complex and riskier than the electricity market. There is a clear perception by new entrants, that of the two markets, gas is harder than electricity for a secondary retailer. By implication, this means that there are fewer gas retailers competing for customers.

At least three of the respondents commented that there is much uncertainty around the long-term price of gas on the East Coast of Australia. Therefore, it is difficult for retailers to offer two to three year contracts to customers given they do not know what the future price is going to be.

Several respondents made the point that gas is not a primary fuel in NSW. In particular, NSW is not as dual fuel ‘centric’ as Victoria in terms of penetration of gas connections and consumption levels of gas. The lower level of consumption means that gas is not as important a fuel in terms of the bills faced by consumers in NSW – especially when compared to Victoria.

As one retailer explained:

*In terms of consumption, in NSW there’s not that same need in NSW for gas for heating as there is in Victoria. The quantum of the bill is \$200 in NSW compared with Victoria which might be \$600 or \$700.*

The lower level of gas bills relative to electricity in NSW means that customers may be less concerned about gas prices than they are about electricity prices. The lower gas bills means that the potential savings to customers are not as significant in gas compared to electricity. Gas is a less important fuel in terms of the bills faced by customers. This, together with the lower levels of customer connections, were the reasons given as to why there is less rivalry for gas customers compared to electricity customers.

Another major reason given as to why the level of rivalry in gas is rated lower than for electricity is the position of the incumbents. One of the small gas retailers said that the level of retailer rivalry in the gas market was less than electricity due to the strong position of the incumbent AGL. It was noted that AGL has been in the NSW gas market for over 175 years and there is strong brand awareness associating AGL with gas. Nevertheless, dual fuel was seen as a better sale than electricity only.

As put by a small gas retailer in NSW:

*...there [are] different forces at play because of AGL's strong incumbency position. They have got obviously a very strong sort of desire to hold on to the gas customer and cross-sell the electricity so their strategy more comes from that. Whereas businesses like us where we can retail both, we definitely would. So a dual fuel sale for us is a better sale than a single fuel sale.*

For this retailer, that ability to offer dual fuel to customers helps it to compete against other retailers who are offering dual fuel.

#### **4.2.2 Importance of dual fuel offers**

As mentioned above, a gas product offering is not generally offered on a standalone basis, or as one retailer put it to us “not pursued with any vigour”. Gas was considered to be a product that was bundled with an electricity product. A small retailer told us that the margins in gas are considered to be much lower than in electricity, therefore there is less of an inducement that can be offered by retailers to customers compared to electricity, and gas customers are harder to acquire.

Several retailers mentioned that dual fuel offers generally came with a bigger discount if the customer took both electricity and gas as opposed to just electricity.

One of the small retailers found that upon entering the NSW market, gas was more important than it had originally thought it would be. The reason for this was partly because of the dual fuel offers that are available from the incumbents. Because the incumbent retailers were using a dual fuel product and discounts to retain customers this had forced a rethink by this new entrant retailer.

This retailer, which does not offer gas in NSW, said:

*So a lot of customers, for example, might have made a decision to consciously move to [this retailer] for a deal on their electricity, but then they find subsequently that their gas prices are going to go up, and then they're cancelling.*

The experience of this retailer upon entering the NSW market was that it needed to offer a dual fuel product so as to retain customers, that is, as a type of retention tool.

A large retailer noted the greater emergence of competitive activity in dual fuel offers in the last one or two years. Retailers are increasingly trying to improve the revenue stream derived from a customer whilst that customer is with them, or using dual fuel offers to acquire more customers. The belief is that a customer is more likely to stay with a retailer if it has both electricity and gas accounts with the one retailer.

The need to offer dual fuel products was not shared by all retailers. Several retailers said that their focus and speciality was in electricity. They did not consider that a dual fuel product was necessary for them to be viable in the electricity market.

### 4.2.3 Perceived risks in gas

The view was presented by some retailers that the complexity of the gas market are something they do not feel comfortable with. Several retailers gave us the impression that retailing gas was all ‘a bit too hard’ – especially for small new entrants. There seems to be a view that, if a retailer wants to enter the gas market, it needs to get a foothold in electricity first. Once a retailer reaches a certain size it can allocate resources to investigate the requirements for entering the gas market. Greater complexity of the gas market appears to be one of the factors contributing to fewer retailers operating in the NSW gas market.

## 4.3 Online rivalry

A new development in energy retailing has been the rise in the importance of the internet. Retailers said that customers are increasingly accessing information and offers online. One retailer said that increased awareness about electricity prices has led to more people searching for information online, and in their own time.

As a result of increased online researching, people are being directed to the websites of energy retailers and switching engines. As one retailer explained:

*This means [people] will go into Google or search engines and they will come up with energy retailers and switching engines.*

From the interviews, we were left with the impression that online retailing was becoming increasingly important for retailers. One retailer divulged that in 2011, it experienced a 160 per cent increase in the sale of online contracts. This retailer said that all its offers are available online and customers are engaging online more and more.

Retailers view online retailing as a positive trend because it gives customers greater access to retailer offers through both retailer websites and comparator sites and switching engines.

A typical comment was:

*We have seen a proliferation now of switching sites, which probably weren't around a few years ago, which gives consumers [a] greater level of access to comparing retailers. And we've also seen the likes of IPART with their own comparison websites.*

During the course of the interviews retailers referred to numerous switching engines and comparison sites such as iSelect, One Big Switch, Go Switch, Shop Around, Switch-wise, Switch Select, Energy Watch; and Electricity Wizards.



Two retailers specifically said that they try to maintain a competitive position on those websites, with one retailer commenting that it is:

*...continuously competing to maintain [its] position on those switching engines.*

Therefore it appears that retail rivalry is extending into the online world. Just as some retailers deploy door knockers and out-bound telesales, some are now placing great importance on positioning themselves online. The online world seems to have created a new type of marketplace where retailers compete to maintain their online presence.

Several retailers also referred to improved accessibility to offers as a result of the increase in customers using the internet. Retailers said that online activity has increased and that, to the surprise of some retailers, that this activity was not confined to any particular type of customer. The online experience of one retailer is shown in the following comment.

*Interestingly enough, regional and rural people, if they are geographically isolated, are actually quite good on the internet. Same with seniors, if they are physically isolated, for age reasons...there is a group of people there that are surprisingly appearing in our results...which indicates to me, from our perspective, we are getting pockets of everyone.*

The significance of the internet is that it places all customers on a similar footing regardless of customer location or demographics. Further, one retailer pointed out that the internet allows customers to access offers and switching at any time. Customers are no longer constrained by waiting for retailers to approach them with a competitive offer.

In our view, the internet is having a positive impact in improving the scope for retailer rivalry on a number of fronts. It provides a geographically independent market for retailers to compete in and provides customers with a convenient method to search for information about energy prices, request and compare competing energy offers from retailers, and accept market offers.

## 5. Awareness and responsiveness of customers

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We sought respondents' views about the extent to which NSW electricity and gas customers are aware of their ability to choose retailers and switch from standard to market contracts. We asked retailers about their experience in approaching NSW customers and the willingness of customers to switch. In addition, we asked retailers their views on what are the drivers of, and barriers to, customers switching.

To gain insights into the evolving nature of the NSW retail energy markets, we sought views as to whether there have been any changes in switching trends during the time they have been active in NSW.

An important issue for this AEMC review is making recommendations about appropriate regulatory options. With this in mind, we asked retailers whether there are any types of customers that may have less access to market offers or are viewed as being less desirable customers by retailers.

### 5.1 Customer awareness in electricity

#### 5.1.1 Awareness about ability to switch

The general view of respondents is that NSW customers have a reasonable to high level of awareness about their ability to switch electricity retailers and contracts. Although awareness is considered to be reasonable, nine respondents did say that customer awareness in NSW has some way to go and could be improved. Some of the small retailers said that they did encounter customers who are not aware of their ability to switch retailers and some who did not know the name of their retailer. These retailers said that some customers seem to "bundle" up all the retail brands together because they all seemed the same.

A common view held by respondents is that customer awareness in NSW has increased significantly in the past two years.

The key reason given for this increased awareness is that the large increases in electricity prices experienced by customers in NSW has resulted in greater media and political attention. Many of the respondents commented that recent traditional and social media attention, and policy reforms have increased awareness about retail competition.

Several respondents noted that the privatisation of the NSW State-owned retailers has increased customers awareness levels. In particular, news that the NSW Government no longer owns the electricity retailers raised consumer awareness about being able to shop around to get a better deal.

The One Big Switch campaign was cited by several respondents to have helped raise the public profile of competition and of the potential savings by entering the market.

As one respondent commented:

*...the constant messaging from governments, regulators and also campaigns like One Big Switch pushed by News Limited...probably have raised that [consumer] awareness. The media played a good role [in raising awareness].*

Another similar view expressed was:

*...One Big Switch, that whole campaign. If anyone wasn't aware of it before then, they were aware of it after it...that's gone a long way to educate customers about their options and their ability to choose a retailer.*

Another retailer said that the Federal Government's increased focus on electricity prices and the introduction of a carbon price has prompted increased customer awareness. In particular, the carbon price has encouraged people to search for information on the internet and has led them to find electricity price offers from retailers.

Quite a few respondents consider that the increase in activities of retailers using direct marketing channels such as telephone sales ('telesales') and door knocking has also been very effective at raising awareness. The view was that these direct forms of marketing stimulate a conversation with a customer which leads to the customer thinking about their current energy supply. In particular, several respondents said that the recent increased door knocking activity of the big retailers has particularly raised awareness of retail competition in NSW.

During the interviews respondents often referred to the increased intensity of the door knocking activities of retailers in NSW. We were told that:

*There wouldn't be many customers in NSW that wouldn't have been door knocked probably a dozen times in the last 12 months.*

Several retailers commented that awareness in regional areas has improved in recent years. This increase was attributed to increased door knocking as well as the privatisation of the State-owned electricity retailers.

It was generally considered that consumer awareness in NSW lags behind Victoria. It was suggested by several retailers that a key reason for the greater awareness in Victoria is because all sectors of the Victorian electricity industry have been privatised for a considerable length of time (15 years) and the idea of competition is well entrenched in the minds of Victorian customers where there has been active retail competition for 10 years.

### **5.1.2 Willingness of customers to switch**

Retailers are of the view that NSW customers are at least willing to have a conversation when they are approached by a retailer. Customers are willing to switch if the offer being made is attractive to them. One retailer made the point that the willingness to switch is very high once customers understood there is no risk in switching. That is, once they have overcome an 'initial hesitancy'.

Another retailer made the point that customers have experienced significant electricity bills in recent years - with some experiencing a doubling of electricity bills over a short period of time. Therefore, there is a perception by customers that electricity is becoming expensive. This perception is making customers more open to switching retailers.

Several retailers referred to the recent rise in churn rates during the past 18 months as evidence of an increased willingness of NSW consumers to switch retailers. We were informed that as at December 2011, 50 percent of NSW customers were on market contracts. This was up from 30 per cent the year before.

We were told by several retailers that the business sector was particularly willing to switch and looking for ways to reduce their energy bills. As evidence of this willingness, one retailer that was not active in NSW said that it was receiving calls from businesses in regional NSW that are keen to get better deals. This was occurring through word of mouth from one business to another business.

We asked whether there are any differences in customer willingness to switch on the basis of location (urban, regional or rural) or customer type (residential or business). From the responses given, there does not appear to be any discernible difference in the view of the retailers. Similarly, when asked about differences between customer segments the common view was that there is not a significant difference.

A typical view as stated by one retailer:

*Not significantly different, domestic versus small business...Small business are very cost conscious...small businesses are absolutely just as competitive and switching rates are very similar to residential customers.*

The view was presented that electricity has traditionally been a “low involvement” and “low engagement” product for consumers. Consequently, the “push” activities of door knocking and telesales are heavily adopted in the industry.

However, quite a few retailers said they are seeing an increasing trend in customer researching and switching online. This trend is an indication that customers are becoming somewhat more engaged than in previous years.

### **Online searching and price comparators**

Noting the discussion above on the changing nature of the electricity market as a result of the internet, one retailer mentioned a recent (unpublished) research paper that reveals NSW customers in particular are more likely to switch based on their own research or looking at some kind of website comparative service. That is, willingness of NSW customers to switch is increasing as a result of customers being able to do their own research via the internet.

Interestingly, one retailer mentioned that 10 per cent of the internet traffic on its website was from NSW even though this retailer is not active in NSW.

Another view was presented by one respondent that in addition to the private comparison sites IPART also has a price comparison site. This respondent said that some people may feel more comfortable using the regulator’s site as it is perceived to be a more independent source of comparison. This was based on the supposition that some people may be somewhat hesitant about using a private third party comparison site.

### **5.1.3 Level of customer switching**

The majority of respondents consider the level of customer switching retailers in NSW to be moderate. Again, most retailers referred to the switching rates in Victoria, noting that NSW churn was not as high as in Victoria but higher than most other markets.

A typical response on the levels of switching was:

*I would say...moderate. I don't think it's quite the Victorian level, but it's higher than most markets.*

Several retailers informed us that churn rates for electricity are 20 per cent in NSW compared to 26 per cent in Victoria. When discussing future trends in switching rates, one retailer expressed the view that the only reason the switching rate would go down is if the regulated tariff is set at an “uneconomic” level and stifles competition. This view further reinforces the importance that retailers are placing on the 2013 IPART electricity pricing determination in influencing competition in NSW.

### **5.1.4 Drivers of customer switching**

The unanimous view is that customer switching is currently being driven by monetary factors such as better prices and discounts. Monetary factors are the primary drivers in the current market because electricity prices have increased significantly in recent years. Several retailers said that cost of living is one factor driving greater switching rates by NSW residential customers. Non-monetary incentives (such as magazine subscriptions) are not considered to be key drivers for switching.

Monetary factors are also driving switching rates amongst the small business customers. Some retailers said that the ability to actually help businesses customers lower their electricity bill is motivating businesses to switch. Other factors that encourage switching by small business customers are improved customer service, account management and product innovation.

One retailer noted that business customers are after more services. It said that reasons for switching include:

*...customer service; account management...having the right systems and tools to...meet their needs, and tailored products...there's a lot of interest out there for people to be more energy efficient and sustainable. So I think a lot of customers are switching...if you can offer a bit of product innovation.*

Several small retailers commented that many small business customers are dissatisfied with their retailer at the moment and are eager to switch to a better deal which is not just discounts but services such as energy management and advice.

### **5.1.5 Reasons why customer do not switch**

Respondents were asked their views about why customers do not switch retailers or contracts.

#### **Customer inertia**

According to several respondents, one of the problems faced by the industry right across the country is that electricity and gas are particularly low involvement products. The comment was made that whilst people tend to complain about their bills, only a small proportion of customers actively seek to do something about it. Several retailers said that addressing customer inertia is a reason for the prevalence of door knocking.

Respondents explained that some customers have the attitude of “why bother?” and “what’s in it for me?” Several retailers said that customers are not compelled by offers of discounts which were largely the same from retailer to retailer.

This inertia was described by one retailer as:

*...just from talking to people, they would say, “Why bother? What do I get? What’s the difference if I go from, you know, AGL at five per cent off or TRU at five per cent off? It’s just - you know, why would I - what’s the reason for - what’s a compelling reason for me to switch?”*

And another comment about customer apathy:

*...I think a lot of it is apathy: they just can’t be bothered.*

One retailer made the point that staying on a standard contract with an incumbent was sometimes in itself a choice that the customer has made.

This point was made in the following comment by a small retailer:

*...one of the reasons that a lot of people stay on contract ...is for the same reason that people stay with the Commonwealth Bank. You know, it’s a big bank and they kind of feel comfortable there, and that’s how it is. You could go to another bank, and get a better deal, and better service, and so on, but that’s just they like it. It doesn’t make the Commonwealth Bank not legitimate, or competition in financial services not real. It just means that that’s the choice that they make.*

Whilst inertia is considered an issue, it is acknowledged by several respondents that customer engagement has improved in recent times and that NSW customers are increasingly searching online for better energy offers.

## **Education campaigns**

When respondents raised the issue of customer inertia, we asked whether they thought something could be done to improve customer involvement.

Several respondents suggested that more could be done to educate customers about retail competition. Several respondents said that there are groups of people on standing offers who non-incumbent retailers cannot reach. As summed up in the following comment:

*But informing and educating those customers is critical because we can touch 75 per cent of them but there’s 25 per cent left who are probably the most ‘vulnerable’ [in terms of not being aware of competition].*

In this case, the inability to reach some customers directly is attributed to not being able to access security apartment blocks; or customers that were at work during the day when retailers undertook door knocking and telesales.

One respondent highlighted that when the Victorian Government decided to deregulate electricity prices, it ran what was considered a successful education campaign with a successful message that encouraged customers to engage in the market.

The respondent’s recollection of the campaign is reflected in the following comment:

*So once [price regulation] is removed and the government is able to say, “We’re not setting the price...So...the power is over to you to start engaging the market and take advantage of it”.*

A small retailer said that its predominant sales channel is door knocking because it is a chance to educate the customer and explain the market structure. It said that it endeavours to educate customers as part of its sales approach.

## **Point of sale regulatory information requirements**

One retailer raised the concern that at the time of the sale of a product to a customer, the amount and type of information that has to be provided to customers is confusing to customers.

This retailer said that information that must be provided at the point of sale is about 20 pages long, is confusing and makes the customer “fearful” about the process. One requirement that was held up as particularly concerning is the requirement to advise the customer of the right to a standard form contract. As pointed out by this new entrant retailer, it is not in its interest to market the standard form contract to customers. This retailer considers that the point of sale information may contribute to customer not wanting to switch.

As conveyed by this retailer:

*You look at the New South Wales marketing code of conduct as a starting point...So you tell them about their right to complain to the ombudsman, you have the right to a standard form contract...you've got to tell them about all the fees and charges...It kind of just puts people off.*

## **Switching process**

The customer switching process is considered by one retailer to present a deterrent to customer switching. The switching process can take up to three months to be completed.

*It's like they make a decision and then, you know, it might take 30 or 40 days before the physical switch occurs and then another 90 days before they get a bill from the new retailer.*

Further, it was noted that the processing period could be protracted if the original retailer raises a dispute about the proposed switch. In the view of this retailer, the protracted switching process can lead to customers thinking “it’s all too hard” and losing confidence in the process.

In contrast to this view, most retailers consider that the switching process itself is easy and does not present a barrier to customer switching:

As stated by one retailer:

*It's easy to switch. It's not a significant event. It can be done - it can be done, for example, online in a few minutes. It can be done over the phone or it can be done at the door or it can be done through response to a direct mail. There are a number of mechanisms available for people to switch.*

We were told by several respondents that in Victoria, the roll out of smart meters will reduce the time it takes to switch customers between retailers. In Victoria, the existing quarterly meter reading cycle will be replaced by remote reading which will help to significantly reduce the time taken to switch customers between retailers.

## **Past pricing intervention**

Two retailers mentioned that in the past, some customers returned to the standard regulated contract after being on a market contract. The reason for this was that the standard contract was cheaper than what new entrant retailers could offer. The example referred to related to the regulatory determination in 2007 that resulted in customers moving from market contracts back to standard contracts:

The situation is described in the follow comment by a small retailer:

*We saw in 2007...and leading up to that determination everyone said that there was going to be insufficient headroom, because by that stage we were already starting to see the volatility in the market.*

*But what actually happened was, because of that determination basically, meant that there ...was not enough margin, is that you actually saw customers going back onto the standard tariffs. So it actually saw not only withdrawal of retailers from the market, but you saw customers going back to the standard tariff, because that's what the three State-owned retailers were coming forward with. So that actually put back the development of the market. So when you look at, like, where Victoria has progressed from, and you look at where New South Wales has progressed from, you know, you don't sort of see the fact that it has actually gone backwards...*

This comment about the movement of customers back to the regulated standing offer contract corresponds to comments made by one of the big three retailers in our discussions about the impact of ETEF on the market in section 3.1.2.

The point being made by the small retailer is that regulatory intervention itself has had a detrimental impact on customer switching to market contracts.

## **5.2 Customer awareness in gas**

### **5.2.1 Customer awareness about ability to switch**

Generally, retailers did not consider there to be any significant difference in the level of customer awareness of their ability to switch retailers between electricity and gas customers. Some respondents said that awareness may be lower but not to a great extent.

As a retailer that offers dual fuel products remarked:

*People don't sit there and differentiate between gas and electricity.*

One retailer believes that given there are more electricity-only retailers in the market there is probably more activity around electricity than around gas. The inference being if there is less consumer awareness it may be because there are fewer retailers operating in the gas market.



## 5.2.2 Willingness of customers to switch

As with customer awareness levels, for the most part, respondents do not perceive there to be any major difference between electricity and gas customers with regards to the willingness to switch retailers. One retailer offered the view that once customers are aware they can switch, customer willingness to switch gas retailers is the same as in the electricity market.

Further one retailer noted that while the level of customer switching in gas is lower than electricity it was increasing. As told to us:

*Again, it's similar to electricity and we're seeing that it's increasing but lower than electricity, or not at the same rate is probably the better way of saying that.*

## 5.3 Customer access to market offers

In the context of consumer protection, we sought respondents' views on whether some customers do not have access to, or are not offered, market contracts.

One of the big retailers said that there is no conscious decision to not make offers to any particular type of customers. This retailer said that it endeavours to cater for all customers and to retain them equally. This view was consistent with the views of the other two big retailers.

Further, it was noted that in terms of consumer protection measures, retailers that are the standing retailer in a particular area (Origin Energy and EnergyAustralia for electricity and AGL, Origin Energy, EnergyAustralia and ActewAGL for gas) are required to make an offer of supply to all customers in that particular area.

Several retailers said they were mindful of approaching 'vulnerable' customers. Because of concerns raised by consumer groups, some retailers said that they avoided areas where there were vulnerable groups. As told to us:

*First of all, [consumer groups] may say that vulnerable customers could be approached inappropriately...So we don't send door to door sales people knocking in areas of vulnerable customers.*

On the other hand, some retailers said that consumer groups may also raise concerns that vulnerable customers are not offered market contracts. One of the big retailers said that it had worked on ways to improve the way it approached vulnerable customers. One example given was that this retailer encouraged consumer groups to advise some customers to access offers on the internet. Indeed, several other retailers said that the internet provided a means for customers to have equal access to information and offers.

A small retailer also commented that they have consumer groups pushing back on retailers approaching certain types of customers such as migrants. The suggestion was made by the retailer that education is important so that these communities can access choice proactively as opposed to reactively.

One retailer did indicate that there is the potential for consumer groups, in partnership with energy retailers, to do more to address issues of access for some customer groups.

Several of the small retailers indicated that where a retailer has experienced problems in the past with credit worthiness then those areas would not be actively prioritised over areas where there were no credit problems. One small retailer said:

*I don't certainly...see what you would call discrimination for people with disabilities or other things, but certainly if you don't pay your bill, you're not very attractive as a customer. So credit is obviously something as retailers, we're concerned about...we wouldn't target areas or regions with known bad credit.*

A small retailer that is not yet targeting residential customers said that if it did start retailing to residential customers, it would likely avoid customers that received certain concessions or rebates. In the view of this retailer, this category of customer requires a large amount of administration and, as a very small retailer it does not have the resources to handle the administrative requirements.

Another small retailer said that it does not pursue customers who cannot understand the contract because of a language barrier. The reason for this is due to the difficulty of fulfilling the voice verification call required as part of the sale. Under the verification process, customers are required to confirm they have understood the terms and conditions of the offered contract. This cannot occur if the customer cannot speak English.

Several retailers talked about the development of digital capability in terms of breaking down some of the geographical barriers or access issues (such as people who work or live in apartment buildings that are not accessible by retailers). The internet provides these types of customers with access to market offers.

It was noted by several retailers that under the NECF, the 'standing' retailer will have an obligation to offer a standing contract. Therefore, under NECF all customers will have access to an energy offer from their standing retailer.

## 6. Structural and regulatory barriers

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One of the key criteria in considering the effectiveness of competition is barriers to entry. Barriers to entry are any type of market structure feature or regulatory requirement that makes it difficult or impossible for a new entrant retailer to enter the market. We were also interested in finding out about any regulatory or structural impediments that may prevent, hinder or curtail the ability for retailers to compete for customers. Further, we asked retailers whether there were any barriers to exiting the market. Exit barriers, if any, may pose an impediment to a potential new entrant from seeking to enter the market if there are barriers to exiting and recouping investment costs.

We also sought views about the importance of economies of scale and vertical integration.

In considering the responses, we looked for trends or similarities in the perceptions and experiences of the big three retailers against the small, new entrants retailers. Our findings are separated into electricity and gas retailing.

### 6.1 Market barriers and impediments in electricity

We asked new entrant retailers to provide an overview of their reasons for entering the NSW market in the first place. The most frequent response was that retailers are building on their existing customer bases in other jurisdictions (most commonly Victoria) and expanding into NSW.

Some retailers said that they can differentiate themselves from the current main players in NSW and decided that there are commercial opportunities in NSW.

When we asked retailers about the barriers to entry and in particular expansion, the retailers proffered a host of what they perceive to be barriers and impediments.<sup>19</sup> The views of the retailers on barriers in electricity are presented in sections 6.1.1 to 6.1.7.

#### 6.1.1 Barriers created by retail price regulation

The majority of respondents we spoke to have strong views about the impact of price regulation on competition in the electricity retail market. The majority view is that price regulation in NSW is hindering the entry and expansion of retailers in the electricity market.

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<sup>19</sup> In this report, the term 'barrier to entry' refers to regulatory or structural obstacles that prevent a retailer entering the NSW market. A 'barrier to expansion' refers to any regulatory or structural barrier or impediment that prevents or hinders the retailer from actively marketing and selling to customers. A 'barrier to exit' is any regulatory or structural impediment that would prevent the retailer from recouping its investment should it decide to exit the market. A barrier to exit may prevent the retailer from entering the market in the first place.

## Price regulation as a barrier to entry

Several of the inactive retailers we spoke to who are poised to enter the market said that the continuation of price regulation in NSW is a factor influencing their decision to actively enter the NSW electricity market or not. In particular, one of these retailers said that the outcome of the forthcoming IPART determination to apply from 1 July 2013 is a key factor affecting the decision about entry into the NSW market.

This retailer said that price regulation represents a barrier to entry that is:

*Number one, two and three on the list. Very important.*

This retailer added that it is not just about the price level today, but also about regulatory certainty going forward. This inactive retailer said that it needed regulatory certainty so as to make reasonable and logical margins. This is a consistent view among a number of the small retailers.

Based on the view of a number of respondents, retail price regulation is seen as one part of a package of regulatory matters that has created greater uncertainty and risk in the electricity market. This uncertainty and risk is heightened in light of the Queensland Government imposition of a freeze on electricity prices in Queensland and the proposed (but now halted) reopening of the price determination to review wholesale prices in South Australia.

While the regulatory processes in NSW are, for the most part, viewed as sensible and transparent, the market has been alarmed by the recent events in Queensland and South Australia. These events seem to be having a negative effect on the sentiments of retailers towards jurisdictions that are not yet deregulated such as NSW. This view is particularly prevalent amongst new entrant retailers and inactive retailers.

In the case of one particular inactive retailer, perceptions surrounding uncertainty about price regulation are uppermost in the consideration of whether to commence operating in the NSW market. This retailer described the types of concerns faced by the Board of this retailer regarding the potential for regulatory intervention in electricity pricing:

This inactive retailer described for us the decision making process underway with regards to whether to enter the NSW market in the following manner:

*[with regards to whether to enter the NSW market] we would look at how the other states have behaved, and the Board [of this retailer]...will be asking me questions along the lines of "Are we going to see the same thing as what we saw in Queensland?" "Are we going to see the same thing that we saw in South Australia?" ...And, I'm going to say, "I don't know." While there is regulatory intervention of any sort, or the possibility of it, I would have to say there could be, and that is going to have to be taken into their consideration when...the Board makes its decision on whether we enter into NSW.*

This particular comment demonstrates the type of uncertainty created in markets where retailers are invited to participate and compete under 'full retail competition' (FRC) but where pricing is not fully deregulated and is not set by the market.

We were told that several retailers have ceased marketing in Queensland due to the imposition of the price freeze. Several respondents said that the events that occurred in Queensland and South Australia have created a precedent that may deter new entrants from entering one market on the basis of their experience in another market.

## Price regulation as a barrier to expansion

Several new entrant retailers said that price regulation is affecting their ability to expand their customer base in the NSW market. Two retailers said that following IPART's July 2012 electricity price determination the regulated tariffs in the Ausgrid area are too low and consequently they have ceased marketing activity in the Ausgrid distribution area.

As told to us by one of these retailers:

*The IPART determination that applied from...last July [2012], did not really give an operating margin effective for us to continue to actively market in the Ausgrid area, although we do currently maintain a customer base in the Ausgrid area.*

In our view, these are significant examples of price regulation acting as a barrier to expansion in the NSW retail electricity market. The two retailers that curtailed retailing in the Ausgrid area said that they do operate in the Essential and Endeavour areas.

One of the big three retailers said that regulatory risk is the number one topic that is raised in discussions with investors. This retailer is aware of smaller companies that have faced difficulties obtaining debt funding to finance their operations as a result of the uncertainty about regulatory decisions.

This problem was reiterated by a smaller retailer who said that regulatory decisions flowed through to its financing costs. It said that banks will balk at lending money to small and medium size businesses where there is a risk of unexpected regulatory changes. As explained by an inactive retailer:

*...[regulatory decisions] flows through into financing charges....it would be difficult for us to buy money against the Queensland book because [of the] price freeze...banks just go "Gee, regulator, no way are we lending money for that". I don't think the governments realise how much impact they have on small, medium size businesses.*

Other retailers that are active in the SME market said that they will not enter the residential market because of the existence of price regulation.

Several new entrant retailers described the regulated price as a 'competitor'. The point made was that the regulated tariffs in NSW provide little headroom for new entrant retailers to compete on a commercial basis. As expressed by one of these retailers:

*And so, if your competitor is giving you little head room, then obviously, as a new entrant, it's very difficult to compete.*

This retailer explained that the regulatory framework that applies to retailers includes customer protection frameworks, green energy schemes and other requirements. And so, if the regulated price does not provide enough head room to pass through all these costs, then it makes it even harder to compete with the regulated tariffs.

One retailer was critical about the approach to setting regulated prices in NSW. This retailer said that the approach up until 2010 was based on replicating the "efficient" market price. This retailer disagreed with this approach and considers that if trying to facilitate competition then the intent of regulated standard tariffs should be to set a price that sits in the market alongside the competitive price.

Several respondents described what can be referred to as an ‘asymmetric risk’ of getting the regulated price wrong. As an example of the potential detrimental impact of price regulation, several respondents noted that if the regulated price is set too low then this will destroy investment and competition. If the regulated price is set too high then this will be eroded by retailer competition.

This issue of asymmetric risk is conveyed in the following comment by one retailer:

*...when you have a regulated price you're basically relying on somebody external ...to predict the future price path of the market and if they get it completely wrong they can destroy investment, if they get it completely right and actually put in too much headroom, the market will basically address that by eroding the margins away to a competitive level.*

## 6.1.2 Extent of barriers to wholesale electricity

We heard from several of the new entrant retailers that it is challenging to obtain wholesale cover in NSW especially when compared to Victoria. The NSW generation sector is viewed as a far less proactive generation market than Victoria in that it is less open to dealing with small retailers.

Three respondents commented there are issues with the NSW Government-owned generation sector. There was a view presented that NSW generators are less willing to trade with the small new entrant retailers. There is a view that generators are more used to dealing with the (at the time) State-owned retailers or “cousins” as one of the respondents described the relationship.

This is considered to be less of an issue since the privatisation of the State-owned retailers. Further, respondents consider the privatisation of the NSW State-owned generation assets should further diminish this issue.

A small retailer told us that:

*Well, you've got Macquarie [Generation] but they won't deal with small retailers...they have extraordinarily strict credit limits in place. So they wouldn't deal with us.*

The issue of the strict credit controls was raised by several other small retailers. Dealing with the NSW State-owned generators and the imposition of strict credit controls is viewed by these retailers as a significant barrier.

On the issue of the forthcoming privatisation of the NSW State-owned generators there is a view that it would benefit for retail competition in NSW if one of the generators was to be split up and sold to different companies.

A typical comment made about the proposed privatisation was:

*It depends on what the market looks like once it's done. Indeed if they were to do things that have been talked about like splitting Macquarie Generation into two entities, that's as long as separate companies buy them, that could increase the competition.*

It was put to us that the industry is happy to have the NSW generation sector privatised. This happiness was qualified by the concern by some of the small retailers about the outcome of the sale. It is hoped that the outcome of the sale will not result in “too much”

vertical integration in NSW. It is generally understood that the ACCC will play an important role in influencing the extent of vertical integration in NSW.

One of the small retailers expressed uneasiness about the outcome of the proposed privatisation. This retailer flagged that the potential for greater concentration of generator ownership would force it to rethink its wholesale strategy. This retailer is not in a position to buy into the NSW Government generation sale, but said that it did have the option to build its own generation capacity. However, to build generation capacity requires at least three years lead time, so the dilemma is whether to make the call to invest in new generation capacity or hope that ownership of the wholesale assets will not become more concentrated.

We heard from several retailers that the Sydney Futures Exchange and other third party intermediaries are able to provide wholesale cover. These instruments provide an alternative to dealing with generators; but, purchasing these forms of cover is more expensive than purchasing cover from the generators.

### **6.1.3 Market prudential requirements and network credit support**

Several retailers said that the market prudential requirements make retailing a very cash intensive business. Several of the small retailers consider the market prudential requirements to be a significant barrier to small new entrant retailers. Two of the smaller retailers explained that as market share increases, the financial obligations increase.

These retailers raised these financial obligations, which include Australian Energy Market Operator's (AEMO) prudential requirements and network credit support requirements, as an impediment to expansion.

This concern about prudential requirements is explained here:

*The market operator requires you to put a huge amount of prudentials up for your customer load. And that's, six weeks of electricity payments in advance, times by a volatility factor. They don't take any consideration that we've got hedges in place so there's no offsetting of financial hedging and things like that...So just going into retailing can be, you know, extraordinarily cash-intensive. So it's very expensive. And there's a delay. So I sell to you; [but] you don't pay me for three months but I have to keep paying [prudentials]*

One respondent considers that prudential requirements become more onerous beyond a certain size. This respondent considers the prudential requirements place a limit to the size that a retailer can reach. As explained by the respondent:

*You won't see very many retailers in between 500,000 customers and 2,000,000 and there's a reason for that and that's because ...[of] the high cost of prudentials and...all the financial stuff you have to put down for customers. So if you look at the smaller second-tier retailers, they'll be between, you know, 50 to 500,000 customers. And it seems to be a barrier of you can't get bigger than that. You almost consume yourself to get bigger than that.*

Several retailers said that the network credit support arrangements in NSW create a barrier for smaller retailers because the NSW approach requires retailers to have Standard & Poor's or Moody's type credit rating. Retailers who do not have a sufficiently high credit rating are required to put in place credit support arrangements.

The Victorian approach to network credit support arrangements is viewed by one retailer as a preferable approach. The Victorian approach allows for an alternative rating that allows retailers to have a certain credit allowance with the networks. This allowance frees up capital for retail businesses that can be used to fund growth.

The comment was made that:

*In Victoria you run with a Dun & Bradstreet model where even if you don't have a Standard & Poor's or Moody's type credit rating, you're given a certain credit allowance through your Dun & Bradstreet rating.*

*Now that takes a massive capital requirement out of the business. So the ability to grow is pretty much dictated by your ability to fund a working capital to support that growth. Anything that adds to the working capital of the business, such as credit support requirements, certainly slows the potential growth down to the available capital that you put into the growth.*

The NECF adopts the Victorian approach to network credit support. It is considered that the network credit support requirements under NECF will improve retail expansion conditions for smaller retailers. NECF is scheduled to be implemented in NSW on 1 July 2013.

#### **6.1.4 National Energy Customer Framework**

Many respondents referred to the decision by the NSW Government to defer the implementation of NECF<sup>20</sup> as a barrier to entry. It was explained that when NSW decided to defer the NECF it created problems for some retailers that were about to enter the market. In particular, some retailers that had put in place NECF-compliant (but not NSW-compliant) systems were forced to alter their systems when NSW delayed the introduction of NECF. Further, some retailers had to put a stop to entering the NSW market due to the absence of NECF, particularly as a result of a mismatch between licensing arrangements under NECF and under the current NSW arrangements.

As one respondent commented:

*NECF is important...as an example the regulatory risk...and people were three weeks out from potentially thinking they were going to be under the NECF until June this year [2012]. They hadn't gotten a New South Wales retail licences in the expectation that a national licence would be sufficient from the AER and then they had to do a mad scramble to get authorisation to operate in the market here. It was addressed with the government and regulator's help but, you know, major implications for potential new entrants at the time. There were two or three of them.*

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<sup>20</sup> The NECF involves the harmonisation of State-based regulatory framework (excluding retail price regulation and community service obligations) for the retail energy market and energy distribution sector into a single set of national rules. The focus of the NECF includes a range of energy-specific consumer protections.



Several respondents consider that if the NECF had commenced on 1 July 2012 as originally intended, it would have provided an enormous amount of benefit for new entrant retailers. An inactive retailer commented that as a business, retailers want the regulatory environment to be certain so that when building systems, processes, policies and procedures, they know that these systems and business decisions will be suitable for the longer term.

In the absence of NECF, retailers face replication of costs when entering a new jurisdiction. As explained by one retailer:

*...if you're a Victorian retailer under the NECF...if you had a million customers, and your system had cost you a million dollars, then your next customer would cost you under a dollar to acquire. But as it stands [without NECF] we have to build another million dollars worth of system to comply with NSW.*

The introduction of the NECF on 1 July 2013 will standardise regulatory requirements and reduce costs for retailers operating in multiple states. This will reduce costs for retailers entering new markets and will be beneficial to retail competition.

### **6.1.5 Regulatory requirements**

Several retailers raised the issue of NSW-based regulatory and licensing requirements as a barrier to expansion in NSW. It was explained that state-based requirements are a business consideration in terms of costs of entering into a market.

There was a view presented that the retail sector is highly regulated and that it is arduous for a small retailer to keep up with all the regulatory requirements, especially when operating across multiple jurisdictions.

#### **Green schemes**

As part of the interviews, retailers were specifically asked if there are any State-based environmental schemes present a barrier or impediment in NSW.

Two of the new entrant retailers highlighted the requirement in NSW to offer green power to customers who were enquiring about electricity offers. These retailers consider this requirement to be a hurdle to entry and expansion.

One respondent said that some energy efficiency schemes and the solar bonus scheme added complexity to retailing in NSW. It was noted, however, that most other states have versions of similar schemes. Therefore relative to other states, the NSW schemes are not perceived to impose any significant NSW specific impediment.

A small retailer said the compliance schemes means that a very small retailer like itself is required to have a resource on environmental compliance and regulations. This represents a relatively substantial additional cost to the business.

On a positive note, one retailer noted that removal or winding-back of NSW-specific green schemes would have a positive impact and would remove a cost impediment to operating in NSW.

## Regulatory red tape and red ink

There is one NSW requirement in relation to billing that is considered to be particularly frustrating by some retailers. We were told that one of the NSW licence conditions requires electricity bills to include a statement regarding how much of an average household bill can be attributed to the carbon-pricing mechanism. The text is required to be printed in a certain colour font, 'pentane red'. Apparently, this is a different type of ink to what is required for printing barcodes and other information on customer bills.

One retailer said that it had been a problem because it had to change the way bills are printed and this has created complexity and added cost. This retailer's view is that this type of requirement may create a barrier to entry.

This retailer explained:

*So apparently the barcodes have to be in magnetic ink because the banks use them, but then ...if you do switch to colour printing the coloured printing is not in magnetic ink, so, yes, that could be a barrier to entry. [And further] ...That has got to be in white background with a border around it as well, in a special-sized font.*

Two retailers said that they found the NSW licensing experience to be very frustrating. An inactive retailer said that its business strategy is to target business customers and not residential customers. This retailer said that in applying for a NSW licence it was required to align its billing system to the concession rebates in NSW even though business customers do not receive these concessions. This retailer found the NSW licensing body to be inflexible on this and other issues:

As told to us:

*Concession rebates, you have seven – eight concession rebates in New South Wales. We had to make sure that we aligned our billing system with all eight of the concession rebates...And businesses don't have concessions.*

*We needed to prove that to the New South Wales IPART that we were compliant to the general regulations that they have, in regard to the electricity licence.*

In this particular case this potential retailer was required to spend money on systems that was not part of its business model. The view is that these types of NSW based requirements add complexity and cost which in turn heighten barriers for small retailers.

Several retailers commented that the amount of regulation has increased in recent years. One of the retailers said that NSW is the most challenging jurisdiction. This is mainly because the interpretation of the regulatory requirements by IPART changes over time.

## 6.1.6 Legacy tariffs

Several respondents mentioned that obsolete tariffs still in place in the Essential Energy distribution area create a barrier to competition. Obsolete and unprofitable tariffs create a barrier to expansion because they are difficult to compete against. Customers on the obsolete tariffs have no incentive to switch to a market contract that is likely to be at a higher price.

Three retailers (one big and two small) noted that over time this situation was slowly improving through the removal and streamlining of obsolete tariffs and making adjustments under the allowed regulatory price increases or ‘side-constraints’.

### 6.1.7 Costs to exit the market

We asked retailers to consider whether there were any barriers to exiting the market that may act as a disincentive for retailers to enter in the first place.

Some respondents found this question perplexing because they did not enter a market with a plan to exit the market. Exit costs did not generally factor into their business plans.

One retailer did say that there are large wholesale costs of exiting a market as a result of customer protection measures. These protection measures require retailers to honour the retail supply contracts they have with customers. This means that retailers cannot simply ‘jump out’ of a market.

As explained by this retailer:

*So by exit, you can't always just jump out. You have got to honour your original customer contract. If they don't choose to leave then we still keep honouring that and there's a fixed cost of being in the market from a regulatory perspective. Each state we spend two or three million a year just to keep up to speed. From the wholesale perspective it gets even worse sometimes because there's often a reason why we're exiting a market and it's because there's not enough margin, and we will be losing money in certain states from a wholesale perspective.*

Another retailer said that the only barrier to exit was to find another retailer to novate or sell the contracts across to. That is, the retail business or customer segments can be sold to another party.

## 6.2 Importance of economies of scale in electricity

We asked respondents whether economies of scale are important to be competitive in the market. In particular, we were seeking to find out whether small retailers are disadvantaged because of their size when compared to large mass market retailers.

We found that respondents do not consider economies of scale to be a major issue affecting entry or expansion. However, having an established customer base in another jurisdiction seems to be an advantage for entering and expanding into the NSW market.

Respondents generally recognised that there are fairly strong economies of scale within retail businesses. A common view, however, is that the importance of economies of scale depends on each retailer's particular business model.

One retailer explained that the large retailers are required to spend hundreds of millions of dollars on business systems. This amount of investment is needed to be able to deliver on the scale and operational efficiencies required by the size of their customer bases. The point was made that a smaller retailer does not need to invest hundreds of millions of dollars in

systems in order to enter and compete in the NSW market. Instead, smaller retailers invest in systems which are adequate for their size and growth.

Several of the small retailers said they can access economies of scale by outsourcing key operations. As explained by one respondent:

*So it depends on your model as to how important it [economies of scales] is...most people go with the outsource model...they perceive that that's the way to get around scale issues.*

We were told that some larger Victorian players adopt an outsourcing approach when they move interstate. It was explained that retailers can obtain local and overseas billing systems that are outsourced and fully serviced.

It was pointed out that most retailers are, or are planning to be, national retailers. Therefore, if an interstate retailer with a medium sized customer base (of several hundreds of thousands) enters into the NSW market, the retailer can 'match' the new NSW customers into its existing systems.

Therefore, economies of scale across a total customer base, not just the NSW customer base is considered to be important. Several respondents indicated that their Victorian customer base is their stronghold while entry into NSW was for the incremental customer base. This strategy is reflected in the following comment:

*...we're not chasing a certain market share in New South Wales. We're looking for...customers who will be with us for the period of time they will say they will be us for and, you know, meet our shareholders' expectations.*

There was another view that NSW presents an opportunity for some Victorian-based retailers to become less dependent on the Victorian market and seek out economies of scale from growth in NSW.

One of the small retailers pointed out that the big retailers may have disadvantages that smaller retailers do not have. This retailer considers that a small retailer can be efficient relative to the big retailers.

This retailer said:

*But it's certainly possible for a small retailer to be very efficient. And big companies, while they do get some scale, they also end up ...with layers of management that have become unnecessary, and...they get this whole syndrome where to change a light bulb, it costs, like, \$12,000 type of stuff...*

## **6.3 Importance of vertical integration in electricity**

When we asked about vertical integration, respondents presented a range of views about its importance to retailers. The views ranged from vertical integration being hugely important to not at all necessary. As with retailer views on economies of scale, we heard that the importance of vertical integration depends on the business model of the retailer.

As discussed in Chapter 2, nine of the active retailers are vertically integrated with generation assets – through a combination of ownership, contracting arrangements or joint venture

arrangements. Four of the active retailers are not vertically integrated with wholesale electricity assets and are pure electricity retailers.

The view of one of the big three retailers is that vertical integration is very important to the company and its investors. It was explained that energy market prices are very volatile and the investors in the big retail businesses expect a certain consistency in revenues. One big retailer said that the volatility that comes with seeking to hedge through market arrangements is probably beyond the risk tolerance of its investors. This retailer considers vertical integration (through ownership of physical generation assets) and long term contract arrangements to be important ways to hedge against energy price volatility, and provide certainty to investors.

As a way of managing this volatility this retailer made the point that:

*So, naturally, we've gone to vertical integration to manage the volatility...we need to hedge with physical. Either physical assets or...long-term contracts with an owner of the physical asset.*

*Now, that could be via an intermediary or not, but definitely being able to - you've got to think about the lifetime of a customer and, sure enough, customers tune in and out but they're fairly homogenous in that, over a certain amount of time, we know we've got a risk exposure and we need to match that with hedging arrangements...you know, thinking one year at a time is not - doesn't work from a risk tolerance point of view for a company. It might be - it might give you greater revenues in any one particular year but it doesn't match what your investors are looking for. So, yeah, upstream investment is really important for us.*

Similar views about the importance of vertical integration as a means of managing costs and risk are held by the other two big retailers. One of the big retailers said that the question of whether vertical integration is important depends on the business model of the retailer. It explained that for a retailer of its size, upstream ownership of electricity and gas sources allowed it to be able to better understand and manage its cost structures. This provides it with some longer term cost certainty. It also said that it purchased from the market for the load that was unaligned with its wholesale interests.

This retailer said that:

*So we're a participant there as well [wholesale markets]. So it helps us to be able to have some certainty on being able to provide a competitive cost to the end consumer. It's not the be all and end all and everything but, on the other hand, if we own nothing then, effectively, you become exposed to a very volatile market.*

One of the big three retailers referred to the problems in the Californian market in the early 2000s, where retail prices were not allowed to rise with wholesale prices and there were severe electricity shortages resulting from a mismatch of supply and demand. To add to its explanation of why vertical integration was important to it, this retailer said:

*Now, mix that [market volatility] with governments who set tariffs in some states, and we have a potential Californian situation back in the early 2000s where the volatile [wholesale] market outstripped the retail market.*

Other respondents noted that not all the larger retailers are completely vertically integrated. Instead, parts of their unaligned portfolios are traded on swaps, hedges and other market arrangements. We were told that physical assets provide a better risk management option, and can provide retailers with some control over its own costs, but it was not considered by all respondents to be an essential prerequisite to having a competitive retail business.

Further some retailers indicated they may build generation capacity in the future, depending on the level of liquidity in the market. This view is demonstrated in the following comment:

*There are retailers who have no generation. As long as they get a hedge through the markets and there is liquidity they're confident in managing their risks, but there [are] others that sort of think...you don't need a large amount of vertical integration but you might want to have a pegging plan if you need one.*

A small retailer that is not vertically integrated noted volatility in wholesale electricity markets can present challenges especially in the context of seeking an adequate return on investment from generation assets – especially during periods of low wholesale prices. Similarly, another small retailer said that it holds the “contentious view” that you can very well compete without being vertically integrated.

Another small retailer predicts that in the longer term there will be more consolidation of the retail and generation sectors. This retailer observed that the big three retailers were “home growing a lot more of their generation”. One respondent commented that if the market does become more vertically integrated in the longer term this may create difficulties for other generators and retailers.

## 6.4 Market barriers and impediments in gas

### 6.4.1 Extent of market barriers and impediments

Respondents generally consider gas retailing to be a more complex business for new and small entrants. The reasons for this include market structure issues, access to upstream gas, gas trading arrangements, and access arrangements with gas pipelines and networks.

A small retailer observed:

*It's less competitive than energy because you've got the big sellers and the big retailers...so it's very difficult to come in and get gas contracts. It's not traded as frequently as electricity...you actually need to buy space on the pipes and...have all these network agreements.*

#### Wholesale gas sources

One respondent that is not active in gas said it is difficult for a small retailer to negotiate the supply of small quantities of gas. This retailer considers that it is difficult to purchase small quantities from upstream gas interests. The alternative of going to another gas retailer for gas supplies is more expensive.

This view is reflected in the following comment:

*[if] you just wanted small amounts of gas, it's much more difficult to get [a small quantity] than if you're buying, you know, hundreds of TJs. You go in there and go, "We just want one TJ for next year, please", it's like, "Yes, right." They can't be bothered with you sort of thing. Which means you pay a higher price for having to go to an AGL or a TRU and saying, "Can you please sell me, you know, one [TJ]?"*

One of the big retailers noted that retailers have the option of take of pay contracts, or buying from the Short Term Trading Market<sup>21</sup> (STTM).

When asked whether the STTM is an alternative for obtaining gas, a small retailer said that the STTM is too risky to operate in. Two other new entrant retailers made similar comments about problems with access to the wholesale market.

*You need to buy bulk volumes of it. There's no efficient market like electricity with the futures exchange to buy gas. So that's one of the major impediments for anyone trying to enter the gas market. You need to almost make a punt on, "I'm going to have this many customers and I need this much gas" otherwise no one will contract with you - you're dealing with oil barons.*

One of the small retailers that it is not active in gas retailing said it has not looked at the gas market in any depth because of its concerns about the market structure in NSW. When we asked this retailer what could be done to address the perceived barriers to entry, the retailer said that one aspect to resolve would be the wholesale arrangements. It was also suggested that a review of some sort may need to be conducted of the whole industry to investigate barriers at any point in the industry.

Another respondent considers there is merit in developing a domestic gas policy to assist in providing more certainty about security of gas supplies.

## Transport and storage

Another aspect that seems to be an impediment to retailing in gas is the greater complexity surrounding the transportation and storage of gas. The point was made to us as follows:

*You need access along those distribution networks. If you buy too much or too little which you're settling at five points within a day, you then need somewhere to store it if you have got too much or too little. Or then you need to sell it into a spot market which as soon as you're forced into that position you may as well roll the dice as a retailer. So gas, a huge impediment.*

One retailer talked about the different carriage models and considers that the Victorian approach is better. NSW has a 'contract carriage' model, while in Victoria there was a 'market carriage' model which means a retailer does not require a haulage contract with a pipeline. This retailer said that this difference contributes to a more vibrant gas market in Victoria.

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<sup>21</sup> The STTM is a market-based wholesale gas balancing mechanism that is designed to facilitate the short term trading of gas between gas suppliers, pipeline owners and market participants (retailers). For more information, see <http://www.aemo.com.au/Gas/Market-Operations/Short-Term-Trading-Market>

One respondent said that the NSW models suits incumbent players who know what their load is going to be and have existing contractual positions to cover their gas requirements. It was more of a challenge for a new entrant retailer with a growing customer base and greater uncertainty about its gas requirements.

This retailer outlined the challenges as follows:

*When you've got to actually bilaterally negotiate those contracts, [it] is challenging and getting gas into the regional areas and into areas where you've got to nominate how much gas you would require into each pipeline or each delivery point on a discrete basis does create a lot of challenge for you.*

In terms of access to pipelines, a new entrant retailer explained that new entrant retailers were penalised quite heavily when actual demand did not align with forecast demand. This retailer takes the view that the market structure and the agreements around gas pipelines discriminate against a smaller business trying to build a position, and can act as a barrier to entry and expansion in the retail gas market.

Two retailers referred to difficulties with dealing with gas distribution entities. The view presented to us was:

*My understanding is that there are no real, what we call, B2B procedures, up there [NSW] for gas, which is how retailers communicate with the networks, in order to actually transfer a customer. There doesn't seem to be that procedural infrastructure in place in the gas market, like there is in electricity. So it's much harder to actually acquire a customer in gas, is my understanding. And ... the distributors hold a very, very significant degree of market power up in the NSW gas market.*

One of the large retailers said that currently there was plenty of gas available but that this may change as LNG exports from Queensland commences. Similarly, several respondents including one of the big retailers commented that there is uncertainty about future supplies and price of gas but that generally all retailers were facing the same issues on this front.

Some respondents said that the industry generally believes that there will be a gas shortage in two or three years. Another retailer, however, speculated that the development of shale gas in the US will avert the problems of gas shortages in the near future.

The potential development of coal seam gas in NSW was seen as a way to mitigate some of this uncertainty of supply and price. Respondents are of the view that new sources of gas will be beneficial to competition in NSW. Some respondents said that coal seam gas could potentially be used for base load generation. There was uncertainty by several respondents as to whether the coal seam gas industry in NSW would actually emerge, and not get politically beaten down "with environmental concerns and certain radio hosts".

## **Obtaining information**

The experience of a new entrant retailer that is active in the NSW gas market was that obtaining information about the process, regulatory environment and protocols for operating in the NSW gas market was very difficult.

This retailer drew a comparison between NSW and the regulatory authorities in Western Australia (WA). This retailer had attended several road shows where the WA regulators come across (to Victoria) to educate this retailer about the WA market. The purpose of the



road show was to encourage investment in the WA gas sector. This retailer considers that the NSW authorities could do more to provide information to potential market entrants about the operating environment for gas in NSW.

### **6.4.2 Costs to exit the market**

On the matter of exit costs we were told that gas retailing is more of a fixed cost business because the product bought is in fixed amounts of product and distribution. One respondent said that a retailer will spend \$30 million to enter a market for one customer or 300,000 customers. This made it difficult to exit the gas market because of the high costs that needed to be recovered.

Further, exiting the market would need to occur on contract closure, but the contracts end at different times. Therefore exiting from the gas retail market is complicated and likely to be costly to administer.

## **6.5 Importance of economies of scale in gas**

The common view expressed by respondents to the question of the importance of economies of scale in gas is that there is little difference between electricity and gas.

The view commonly put to us was that a retailer is not going to be in the gas market without being in the electricity market. This is because there are more customers in electricity than in gas and gas is a fuel of choice rather than an essential energy source like electricity. So generally, retailers that are in the electricity market are able to retail gas on the back of the electricity operations.

On the issue of vertical integration, the view can be summed up by a comment made by one retailer who said:

*I would take a gas field over a power station if I had a choice.*

The reality, however, is that there is limited opportunity for retailers to be vertically integrated with gas sources.

## **6.6 Importance of dual fuel**

We asked some respondents whether not having a dual fuel product was an impediment. The common view is that gas is not as important as electricity given that not all customers are connected to gas. For some retailers dual fuel is an important part of their business proposition and helps them to win customers. One of the big retailers did say that having gas did help with gas selling into electricity and vice versa.

Three of the new entrant retailers that do not retail gas in NSW and that target medium to large business customers thought that it is not an impediment but that having gas could win a few extra customers. We discuss dual fuel products in section 7.5.

## 7. Product offers and marketing

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In assessing the competitiveness of the NSW energy retail markets, the AEMC is required to consider the types of products and services being offered by the retailers. The existence of a range of differentiated products and services and continued innovation is a sign that retailers are actively looking for new and innovative ways to attract customers.

Our set of questions focused on asking retailers about their product offers to customers and whether there have been changes to the type of products and services on offer since they have been in the market and whether they offer time of use pricing. We asked retailers what is driving their product development and how are they seeking to differentiate themselves from other retailers. We asked about potential product and service developments should more NSW customers be provided with advanced metering (interval or smart).

We also asked retailers about how they market their products and services to customers and which channels they find to be most effective and about possible changes to marketing efforts in the future.

We asked about the impact of consumer protection measures and how retailers dealt with customer complaints.

### 7.1 Products, innovation and differentiation in electricity and gas

Retailers were asked to describe the types of products and services they currently offer. The types of products and services that the retailers offer very much depend on the type business model the retailer has adopted and the types of value proposition the retailer is looking to deliver to its customers.

We discerned that retailers offer a variety of value propositions offered by retailers to their respective customers. The propositions are designed to appeal to a broad range of customer preferences.

The large retailers had a range of propositions that include:

- strong brand representing values such as reliability, credibility, trustworthiness and leadership
- discounts and rebates
- fixed prices for a certain period of time
- green products
- pay-on-time discounts
- loyalty programs
- online portals for accessing consumption information and other energy services.

The main features of the propositions offered by the small retailers include:

- being local and accessible

- being part of the community (through community sponsorship)
- traditional account management services and customer services
- a human voice that answers our call centre
- Australian based onshore call centres.

Table 2 below shows the types of the products and services offered by the three big retailers we interviewed.

This is not a comprehensive list of the products and services and is intended only to show the different types and range of product and service offerings offered by the different categories of retailer. What it shows is that the big retailers have a larger range of products and services intended to appeal to the mass market of small customers.

The small retailers have a smaller, more targeted set of products that reflect their service propositions (shown in Table 3, below). Smaller retailers launch a small range of products and services that is intended to differentiate them from the offers of other retailers. The strategy of offering a limited set of uniform offers minimises costs and complexity for the small retailers.

A small retailer explained:

*...smaller retailers, like us...choose to enter the market with a relatively homogenised product.*

We have merged the products and services of the retailers into two tables, separating out small and large retailers.

**Table 2 Sample of products and services of the big retailers**

Types of products	Types of services
<p><b>Energy plans</b></p> <ul style="list-style-type: none"> <li>• Two year fixed rate product.</li> <li>• Plan with no lock-in contract and no exit fees. One per cent discount on usage for direct debit.</li> <li>• Direct payment plan with a 1% discount on electricity usage costs.</li> <li>• Regulated plans.</li> </ul> <p><b>Energy plan offers with discounts:</b></p> <ul style="list-style-type: none"> <li>• 12% base discount on electricity usage for 12 months.</li> <li>• An additional 2% discount on usage for paying on time.</li> <li>• an additional 1% discount on usage for both electricity and natural gas for up to 12 months.</li> <li>• An additional 1% discount on usage when pay by Direct Debit.</li> </ul> <p>And:</p> <ul style="list-style-type: none"> <li>• Discount products with varying discounts and contract lengths</li> </ul> <p>And:</p> <ul style="list-style-type: none"> <li>• Discounts of 14 to 15 on per cent on electricity</li> <li>• Discounts of 12 to 14 type per cent on gas</li> </ul> <p><b>Rebates:</b></p> <ul style="list-style-type: none"> <li>• Offer a rebate to the customer who switches to it for the first time on their first bill of around \$100 or \$150. This is intended</li> </ul>	<ul style="list-style-type: none"> <li>• Acquisition offers – e.g., magazine subscriptions, gift cards, rebates.</li> <li>• Bill Smoothing functionality.</li> <li>• Time-of-use tariff options.</li> <li>• Loyalty program.</li> <li>• Energy efficiency services.</li> <li>• Retail shop fronts selling appliances.</li> <li>• Energy consumption report available upon customer request to all customers.</li> <li>• Online portal to customers (Victorian customers only).</li> </ul>

Types of products	Types of services
<p>to help customers with any termination fees</p> <p><b>Green products:</b></p> <ul style="list-style-type: none"> <li>• 10% Government accredited green power for free</li> <li>• 25% Government accredited green power</li> <li>• 50% Government accredited green power</li> <li>• 100% Government accredited green power.</li> </ul>	

Source: Information obtained during interviews or from retailer websites.

**Table 3 Sample of products and services of small retailers**

Types of products	Types of services
<p><b>Retailer 1</b></p> <ul style="list-style-type: none"> <li>• Two year energy contract or electricity contract that has a prompt payment discount on the total bill.</li> </ul> <p><b>Retailer 2</b></p> <ul style="list-style-type: none"> <li>• Contract product with discounts for paying on time.</li> <li>• Non-contract product with discounts for paying on time.</li> </ul> <p><b>Retailer 3:</b></p> <ul style="list-style-type: none"> <li>• Unaccredited green product.</li> </ul> <p><b>Retailer 4:</b></p> <ul style="list-style-type: none"> <li>• 12 per cent prompt payment discount on a three year contract</li> <li>• Lower payment discount on a one year product.</li> <li>• Green product.</li> </ul> <p><b>Retailer 5:</b></p> <p>Pay on time discount:</p> <ul style="list-style-type: none"> <li>• one year contract with 15 per cent discount and</li> <li>• no contract with 7 per cent discount.</li> </ul> <p>Green power, both at 10 per cent and 100 per cent, as an add</p> <p><b>Retailer 6:</b></p> <ul style="list-style-type: none"> <li>• Offer customers an electricity price (rather than a discount).</li> </ul> <p><b>Retailer 7:</b></p> <ul style="list-style-type: none"> <li>• Smoothed monthly payments. Fixed rate on the retail (not network) component.</li> </ul> <p><b>Retailer 8:</b></p> <ul style="list-style-type: none"> <li>• 10 per cent off the usage and 13 per cent off, if you pay on time.</li> </ul> <p><b>Retailer 9:</b></p> <ul style="list-style-type: none"> <li>• Percentage discount off bundled electricity and other services Electricity or dual-fuel offer with a 10 per cent off discount and an upfront rebate.</li> <li>• Pay-on-time discount and rebate.</li> </ul>	<ul style="list-style-type: none"> <li>• Product alliances – discounts for non energy products</li> <li>• Install solar at customer's premises.</li> <li>• Energy management services</li> <li>• 100 per cent Australian based team</li> <li>• Buying card with benefits on other household products and services</li> <li>• rewards product</li> </ul>

Source: Information obtained during interviews or from retailer websites.

We asked the big retailers which of their suite of offers are the most popular. Unanimously the retailers responded that products that offer a discount or rebate (that is, some form of monetary benefit) are the most popular. One retailer said that rebate products have been very popular because customers see an immediate benefit.

A big retailer said that while discount remains the lead driver of customer choice this is shifting. It said that more customers are moving to other propositions such as fixed price products and time-of-use pricing. We were also told by several respondents that customer needs are starting to shift away from being only price-based to more value-added services, such as energy management, self serve options and customised plans. This shift in consumer demands is prompting a shift in retailer offerings.

As explained by one retailer:

*The market has been heavily focussed on discount, which is expected in a commodity market. However, as we better meet customer needs and provide greater value outside of just the supply of energy, we are confident customers will start to choose value over just discount e.g., companies that offer them self serve, actively help reduce their usage and provide them with customised price plans*

In our view, energy retailing seems to be at the cusp of change which is being driven by the changing needs of customers and retailers are starting to better meet the changing needs of consumers.

## 7.2 Time-of-use pricing

A key area of interest for the NSW Review is the issue of time-of-use (TOU) pricing and any impact it may have on competition.

We asked retailers whether they offer products based on TOU pricing. This question was often answered with the clarification that the ability of retailers to offer TOU pricing depends on the type of meter installed at the customer's premises. We were informed that it is only possible to offer TOU pricing where the customer has an interval or smart meter installed.

Several retailers said that Ausgrid was rolling out interval meters to around 500,000 of the customers connected to the Ausgrid network. It was possible to offer TOU pricing to those customers.

The most common response was that the retail price offer made by retailers will follow the structure of the network tariffs in each of the distribution areas. A typical response is reflected in the following comment.

*Where [the] network sets the shoulder [peak and off-peak] we have a time of use product that lays on top of that. But it's effectively the same discounting that we would have on a flat rate product.*

A big retailer said that it had specific TOU prices targeting residential and SME customers. A small retailer that targets business customers said that it offers 'time-of-year' pricing for customers who have TOU meters and network TOU tariffs.

When asked about the potential impact of TOU pricing on competition, there was a mixed response from retailers. One retailer said that competition will increase as competitive capability and understanding of TOU prices increases. Other respondents said that interval or smart meters needed to be rolled out before TOU pricing can be introduced.

When asked about the impact that TOU pricing may have on competition several respondents said that it was necessary to have price deregulation to be able to introduce TOU products effectively into the market. That is, retailers need to be given the ability to set the TOU price and not rely on the regulator setting the price. This is because a TOU price that is set by the regulator would have no bearing on the type of technology that the retailers are trying to market.

As explained by a respondent:

*So if it is the intention...to roll out time of [use] pricing as the most efficient demand side participation...sort of proposal, and then we've got to have regard to the fact that time of [use] price has got to be set by the retailer.*

When asked about the potential risks of TOU pricing one retailer commented that TOU pricing provides an incentive for customers to shift load into less expensive shoulder and off-peak periods. This can help customers to manage their energy use and reduce their bill. And importantly, retailers that have a customer base with a flatter load profile (as opposed to a peaky load profile) will be able to better manage wholesale purchase costs. The cost savings can be passed through to customers through lower prices.

The implication of the views of the respondents discussed here is that the impact of TOU pricing on competition will be most effective when retailers have the flexibility to set the prices. This will enable TOU prices to reflect the available technology, manage wholesale prices and meet the changing needs of customers.

## 7.3 Location of retailing activities

We asked retailers whether they targeted certain areas to get a sense of whether competition was more active in some areas than others.

The big retailers did not confine their marketing activities to any particular area. Although as discussed in section 4.1.3, areas that are close to urban areas are more likely to be targets of door knocking for logistical reasons.

Retailers generally said they confine retailing activities to regions that were profitable. As previously discussed two small retailers do not focus on the Ausgrid distribution area because it is not considered profitable to do since the IPART July 2012 electricity pricing determination.

One of the small retailers commented that it is not marketing in the Essential Energy area because it considered that the incumbent's retention offer is below cost.

There was a clear trend to operate nationally and not just in NSW. This is the national character of the market. However, the retailers demonstrate a readiness to exit markets where it is not commercial to continue operating.

## 7.4 Extent and drivers of product innovation in electricity

### 7.4.1 Low level of differentiation and innovation

The most common view is that there has not been a large amount of innovation in the types of products and services offered by retailers in NSW. The product offers were primarily based on: discounts from the regulated price and upfront rebates (cash rebates).

The main change to these offerings has been in the level of the discount on offer.

Several retailers, however, recently launched a range of new products that vary from a financial discount. The main types of new products on offer include:

- Two retailers said that they had offered a pure fixed price product. In both cases the prices were fixed for two years.
- Three retailers mentioned that they had introduced a pay-on-time discount.

The retailers that offer the pure fixed price product both said that the product provides certainty to customers about the price they will pay for two years. This offer was in response to customers' needs for price certainty especially in light of recent retail price increases driven by network costs and carbon prices. One retailer explained that the customer is guaranteed a fixed price and that the retailer is bearing the risk, albeit a calculated one, in the event that costs go up.

The 'pay-on-time' discount is becoming more prevalent and is viewed by one retailer as a way to overcome the sort of issues retailers are facing in managing bad debts.

Green products are generally viewed as a declining product due to the introduction of the carbon price.

### 7.4.2 Products and services in the pipeline

It is recognised that historically in NSW the level of product and service offerings has been low and has mainly focused on offering different levels of discounts from the regulated tariff.

In a recent change to the traditional focus on price and discounts, at least four retailers said that they have or will be launching a range of value added services. Some of these services are online portals that allow the retailers' customers to access information about their energy use and a range of other services including advice on managing energy use.

One retailer gave us a live demonstration of its online portal. This retailer said that the online portal took a large amount of time and resources to develop. The portal shows a customer's energy use by time of day and provides other information and services for customers. The portal was only available to customers in Victoria with smart meters installed at their premises. This retailer said that the development of the online portal was driven by customers wanting more information about their energy use.

Retailers that discussed online portals said that customers generally lack understanding about how energy pricing works, and how their consumption impacts the bills they receive. In particular, there was a lack of transparency and understanding about what drove consumption levels. Retailers said that customers, however, appear to be interested in getting a better understanding of their energy use and about ways to manage the level of their bills.

As explained to us:

*So all customers would receive is two meter reads on their bill, the beginning of your period and at the end of your period, but there was no awareness do they use more at different types of – different days of the week and the different times within a day. So it was all about giving customers control about what they're using and how much it's costing*

The online portals are intended to give customers more information about energy use and other value added services. There is a clear view by these retailers that customers are becoming more interested in their energy use. This is partly driven by information being available to them on-demand as opposed to only when they receive a bill every 90 days.

When we asked these retailers what is driving these innovations, and why they want to help customers manage their consumption and expectations about their bills, the response was that:

- smart meters have enabled the information to be available and presented to customers, such that retailers can be proactive and offer it to customers as a point of differentiation
- from a competitive perspective it is seen as a way of retaining customers.

As one retailer put it, innovation is important because:

*It's about delivering to customers what they want and if we can actually do that better than anyone else we then are able to attract more customers to us. ...Whilst there might be on [the] one hand what is perceived to be ...providing information to people [who] will choose to use less and hence do you then make less money? But at the end of the day it's about just providing the information back to customers, giving them the choice, but if we can do it better than anyone else then we hope that we can actually then hold on to that customer.*

This position was reiterated by the following statement by another retailer:

*Well, we believe that if we differentiate we're likely to have longer - longer account life. You're more likely to stay with a retailer if the retailer is actually meeting your needs and providing value added services.*

Further, it was added that there is a potential benefit to the retailer in helping customers to manage their load. As discussed in section 7.2, customers that can shift their consumption of energy into less expensive shoulder and off-peak periods can reduce their bills if they have TOU pricing. The benefit to the retailer is that a flatter customer load profile can help the retailer achieve lower wholesale purchase costs.

As explained by one retailer:

*If a customer has [a] nice flat consumption that would be the cheapest way that we could buy for them.*



Where competition is effective, it would be expected that these cost savings are then returned to customers by way of more competitive energy products and services than would otherwise be available.

The development of services such as online portals and other developments is a strong sign from the market that consumers want these types of solutions and that several retailers are moving quickly to meet these emerging customer demands in order to stay competitive.

### 7.4.3 Facilitating innovation

Several retailers pointed to two key reasons for a lack of product innovation in NSW. The reasons given include ongoing price regulation, and the lack of smart meters in NSW.

One respondent expressed the view that a big ‘handbrake’ on product development and differentiation is the existence of the regulated price. This is because the regulated tariff sets a price structure that customers are most used to. Therefore retailers are compelled to follow this regulated price.

As one respondent said:

*When you’re marketing to a customer who you assume is – is a fair chance to be on it, [regulated price] you have to structure your offer so you can sell it based on ....– on the regulated rate [so as to say] “Here is how I [retailer] compare”.*

Several respondents compared NSW and Victoria, where retail prices are not regulated. The Victorian market is perceived to experience a greater level of product innovation. One retailer said that because of deregulation and the roll out of smart meters that in 2013 there will be a whole raft of time of use type products coming to Victoria.

This retailer described the detriment to innovation attributed to pricing regulation as follows:

*FRC does not give you the full suite of products. It allows people to switch retailers, but if you’re controlling the profitability in the markets, controlling the risk management in the markets ...it’s still not [a] fully open market as such. So in a deregulated market, I think the innovation levels are much higher and that’s what you’re starting to see in Victoria now.*

The existence of pricing regulation is considered to stifle product innovation in NSW in comparison to Victoria where prices are deregulated. Further views about the impacts of pricing regulation on innovation are discussed in section 8.3.

### 7.4.4 Impact of smart meters

We asked about the potential impact of smart meters on product innovation. There is a strong view by many respondents that smart meters will enable a lot of innovation.

The drivers for the new product development occurring in Victoria were described by one retailer as consumer-led and technology-enabled. An accumulation (dumb) meter enables retailers to obtain a meter reading every 90 days and the information is the volume of consumption only. Smart meters will enable many other applications. We were told by

several retailers that energy companies are developing a whole host of applications that are being enabled from by the capabilities of smart meters.

Hand-in-hand with the introduction of smart meters, at least two retailers said that there will need to be an education campaign. As one retailer said:

*I think there will need to be a big education campaign that goes with it so we don't repeat the same errors that we had in Victoria...it's just the education and having things like in-home displays so customers know what behaviours to change and,...what their actions are driving. So I think just to have a meter on the outside wall is not going to really be any use to the customer. I think there needs to be education [campaigns] to help them.*

However, not all retailers think that a public education campaign is necessary – and instead see it as the role of the retailer to help educate customers.

## 7.5 Type of gas products

We were interested in finding out whether retailers bundle the dual fuel product into one contract or whether it is two separate contracts and whether they issue one or two separate bills.

There was a variety of response about the contract arrangements including:

- An umbrella contract that bundles up all the services and gives the headline discount. Underneath are the individual product market-based contracts that comply with the licence obligations.
- One contract but two separate bills.
- Two separate contracts and two separate bills.

Retailers said that the main advantage of offering a dual fuel product is that it is convenient for a customer to have a relationship with one biller for its energy rather than two billers. The main advantage to the retailer is in customer acquisition costs. That is, one door knocker at a customer's premises for both services.

When asked about the possibility of having one bill for the dual fuel offer, most respondents explained that electricity and gas operate on different billing cycles. The billing cycles are unlikely to align and this prevented single billing. Several retailers mentioned that most customers did not want a single bill because it increases the impact of customer getting a 'bill shock'.

### 7.5.1 Target customers and segmentation

On the issue of target customers, most of the retailers said that they did not have a target customer. Some of the small retailers were focused on the residential market while others were focused in the business market. These were the particular customer segments where they consider themselves to specialise in. At a more micro level, retailers said that they do not target a particular type of customer.

Although small retailers consistently did say they prefer credit worthy customers. That is, customers with good credit ratings.

The retailers that targeted business customers said that they did not have a particular target customer type within the market.

Segmenting customers does not seem to be important to energy retailers. Several retailers pointed out that their offers are available to all customers online. The implication is that retailers are open to retailing to all types of customers.

## 7.5.2 Marketing channels used by retailers

### Door knocking and telesales

The most popular marketing channels for retailers that are focused on the residential market are door knocking and telesales with an increase in the use of online channels. The majority of retailers we spoke to found these channels to be the most effective for the residential sector.

Door knocking was viewed as an important form of marketing because it involves direct contact for a product that is traditionally considered to be low involvement and low engagement by customers.

As one retailer said:

*From our experience door knocking is the best. I think there's still sort of a bit of apathy out there, so people find it harder to refuse someone in their face than a phone call.*

One of the small retailers said that door to door sales are probably about 60 to 70 per cent of its sales in NSW.

It was noted by small retailers that incumbent retailers have an advantage in accessing standing offer customers. Incumbent electricity and gas retailers are able to access these customers through direct mail and when sending bills to customers, whereas small retailers have to find other ways to access these customers.

While several retailers consider door knocking to be effective for the residential market, retailers that are in the business sector do not use door knocking. Retailers that focus on the small business segment are more likely to use direct mail or cold calling by salespeople or business relationships. Other retailers said that some customers approach them through word-of-mouth recommendations made by their existing customers to other businesses.

Some retailers expressed the view that they will not use door to door because of the negative public perceptions surrounding door knocking and the potential business risks flowing from this.

Another small retailer said it does not use door knocking but prefers to use advertising of its brand and telesales. Door knocking is viewed as too problematic.

One of the big retailers said that door knocking is important but its importance is declining (from over half to less than a quarter of its sales) and the importance of the internet was increasing.

We asked respondents what would happen if door knocking was banned (as is the situation in the UK market).

At least nine of the respondents said that a ban on door knocking would have a detrimental impact on them and competition in NSW. One small retailer put it to us that:

*It would kill a lot of smaller retailers.*

Several retailers referred to the UK where door knocking has been banned. Customer switching rates reduced and retail prices rose.

*And there is actually a clear example of that up in the UK, where door knocking ...is banned. And you've seen a marked drop in churn rates in the UK, as a result, and the investigation has also shown that the incumbent retailers have been able to earn much higher profit rates, as a direct result of that. So it does have quite significant consequences.*

Several small retailers highlighted that one of the large retailers sent out 'do not knock stickers' to its large customer base and that it had done this twice in the last 15 months.

We were told that this type of behaviour is of concern to the small retailers who target residential customers. In particular, it is viewed as detrimental to the development of market competition in NSW. We were told this type of behaviour from a big retailer demonstrates the effectiveness of door to door knocking:

A typical view by a small retailer on this matter is:

*But there's a case here that proves that door to door is highly effective. Yes and also, stopping door to door will minimise switching. Yes and they've done that twice in the last 15 months to the sale of about four million each one. So that proves what the impact of withdrawing door to door.*

Another small retailer finds direct channels effective and uses door to door and telesales to engage in a "conversation" with customers about retail competition and switching to their products. Several retailers hold the view that the incumbent retailers would be happy to see the banning of direct forms of marketing channels. This is because the incumbents have the most to lose from competition from new entrants and competition.

This retailer presented the view that:

*I think that there are certain powers that want to discourage that conversation happening. And I don't think it takes the brain of Britain to work out that if you're an incumbent you would like to shut down both telesales and door-knocking. You don't want that conversation to occur because you can only lose. You know, so if you want a barrier to sort of retain – for entry or you want to stop churn, then taking those two ones out of the way, because of course that's how the customer gets informed.*

Most of the small retailers rely heavily on door to door and telesales, there are several others who consider it to be too problematic.

## **Online marketing channels**

We asked retailers to what extent they use the internet and social media (by social media we mean channels such as Facebook and Twitter) and whether customers are becoming more interactive and getting more internet savvy.

Several retailers said that they have a Facebook page and Twitter account. Several retailers mentioned they used ‘impression ads’ and search engine optimisation and search engine marketing.

This was explained by one retailer as:

*Where you’re clever with your marketing words so that if someone types, you know, maybe “energy, New South Wales” into Google then you will feature higher on the list of search results.*

Retailers saw benefits of using the internet and social media because it allows retailers to measure “click throughs” on their websites (number of people looking at the advertising on websites). It is seen as a low cost way to advertise and to measure the number of click-throughs. In comparing traditional marketing channels, one retailer said that it is difficult to know how many customers are being reached through traditional sources but it is quite easy to monitor the number of people accessing marketing on websites.

As explained by one retailer:

*So if – we know how many impressions we put on a website. We know how many people click through. So we are... finding that more and more people are doing that, but it’s, I guess, hard to compare to some traditional sources which – you know, it’s really hard to measure how many people sort of read a press ad or listen to a radio ad.*

One retailer said that it had experienced a significant increase in the number of customers purchasing on line.

*...people buying our products through the web have increased 160 per cent last year on the year before and 60 per cent on last year, so it’s just going like that, and that’s people taking up direct debit. Our online transactions are just exploding...*

One retailer noted that that internet is having a positive impact on customers in regional areas who until a few years ago may not have been door knocked as much as customers in urban areas.

One retailer said:

*So, with that, you don’t need to have someone knocking at your door to actually have an effective engagement with someone. You can do it very much in a digital world and...It’s an effective channel to market and it’s changing the regional market competitiveness. It has done in the last couple of years.*

When we asked respondents about the potential of social media channels there was some ambivalence shown towards their usefulness in an energy retailing business. There is a view that while it seems important to use from a branding perspective, it did not necessarily manifest into increased sales. Social media was described by one retailer as a bit of a digital billboard and people can put “any sort of comment up on it”. But, in energy retailing the postings are more of a negative flavour.

## 7.6 Impact of consumer protection laws

We sought views about the consumer protection measures and their impacts on competition.

It is accepted that consumer protection measures are needed because electricity is an essential service.

However, there is some retailer dissatisfaction about the current consumer protection framework. Several retailers described the current regime as a 'lowest common denominator' approach. While it is intended to give protections to vulnerable groups that these protection are applied to all consumers. In that respect, the broad brush approach to consumer protection is seen as stifling innovation and the ability and flexibility to do different things.

As one retailer explained about the current consumer protection measures:

*They can have an impact on competition, depending...The regime we operate under at the moment...it's ensuring that there are protections to...the lowest common denominator in terms of educated customer, vulnerable customer, etcetera, and that's applied across everybody.*

*So that creates an issue for ... innovation in competition, so it stifles that sort of ability, to do things differently and provide, you know, different levels of consumer interaction and servicing of your customer base, because of the minimum standards that you have to comply to.*

One consumer protection measure that is considered particularly problematic is the banning of 'early termination fees'. Early termination fees are fees charged to a customer if the customer ends the contract before the agreed expiration date. One retailer said that the banning of termination fees means that retailers will be limited in the type of upfront offers they could provide to customers where customers do not face any penalty if they leave (and after having received an upfront gift).

As explained by the retailer, certain offers are made to a customer on the basis of the expected return from that customer over the full length of the contract period:

*So, for example, where people start to talk about end of early termination fees, well, that's going to make our life harder, because then if, for example, we wanted to offer a jersey, and somebody only stays for the first month, you know, how are we meant to claim back the cost of that jersey...[consumer protection measures] do affect the market, because you're actually reducing the ways in which retailers can market.*

One small retailer said that the consumer protection framework lacked any sort of consistency between jurisdictions, or overarching principles that guided what measures are in place.

This retailer complained:

*They are convoluted. They are protectionist. They are ridiculously ad hoc from state to state...you have to really want to be in the market to be in the market.*

It appears that while consumer protection measures are intended to protect customers they may also be having an impact on the ability of retailers to develop different value propositions.

## 7.7 Recent developments on door knocking

We asked respondents their views about the likely impact of the Federal Court's recent decision on door knocking in *ACCC v Neighbourhood Energy* (27 September 2012).<sup>22</sup>

The small retailer and inactive retailers stressed that door knocking is the most important and cost effective channel for them to acquire new customers. Therefore, the general view of retailers is that the Federal Court's decision has raised the risk of door knocking and was a matter to be taken very seriously. The view is that it will make the industry consider how they conduct their future door knocking activities.

As expressed by a respondent:

*...a general statement would be that any sort of outcome, such as, what you've seen from the ACCC would make anyone re-assess their own – I suppose, their – their – how they conduct their business to ensure that they don't be exposed to anything similar in the future.*

We were informed that, in response to negative perceptions of door knocking activities, the retail industry, through the ERAA, has established Energy Assurance Limited (EAL) and a regulatory code. The role of EAL is to maintain a register of all the doorknockers in the retail energy market. The EAL has the ability to deregister sales agents that breach the regulatory code. EAL monitors by state how many doorknockers are actually active in a particular market. Most of the retailers we interviewed are members of EAL.

We were told that the EAL has proved to be successful and resulted in a significant drop in customer complaints. As explained by one respondent:

*I think there are now close to deregistering about 110 sales agents, so what used to happen before was a sales agent would actually leave one retailer and go work for the other one, even though they have been kicked off. Under EAL all members have to do registrations.*

We asked whether the establishment of EAL will improve the image of door knocking. The response was that door-to-door will always be considered by the public as a problematic sales channel. Further, there still are other industries that use door knocking which do not have such self-regulatory schemes. Instead, the energy industry set up EAL in an attempt to manage the expectations of the industry.

## 7.8 Handling customer complaints

We asked how retailers dealt with customer complaints.

The respondents we spoke to about customer complaints said that they are taken very seriously. Customer complaints affected their image and they are also very costly for the retailer to administer. Respondents noted that there has been an increase in the number of customer complaints as a result of recent price increases.

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<sup>22</sup> The Federal Court made an adverse finding against Neighbourhood Energy and its agents in relation to door knocking activities.

A few retailers described their internal complaints process including escalation processes. Retailers have a range of options for customers to complain including through email, phone, letters, and in person for retailers with shop fronts. Complaints are categorised to identify the cause. One retailer said that those that get escalated to Ombudsman are handled through a specialist team.

When we asked about the nature of complaints we were told that:

- Complaints about higher bills as a result of the introduction of a carbon price have become more prevalent.
- Complaints correlated to the levels of marketing activity that was undertaken.
- Door knocking was a source of complaints.
- Also, the call length is getting longer as a result. The impact is that the average call length (for this retailer) has increased from two and a half minutes per call to three and a half minutes plus. The reason is because customers are asking a lot more questions.
- Retailers are (or were) spending more time explaining the impact of the carbon price to customers. In some cases bill increases could be explained because customers were seeing winter bills. One retailer explained that last July was a difficult time:

*Also 1 July 2012 was a really rough time, because customer went to a winter bill ...and New South Wales, or where we operate, is a winter peaking and they were comparing their bill to their last quarter and at times saying, you know, "My bill's doubled." But if you compared it to the same time last season, it was just the carbon – I mean, it didn't double and it was only the increase of, you know, several percentages because of the carbon. But a higher bill is definitely – we're getting more complaints on that.*

- New types of complaint related to the carbon message required by licensing to be inserted on bills. One retailer said that customers are complaining that retailers are putting 'political propaganda' onto bills.

We were told by one of the respondents that the establishment of the EAL has had a substantial effect in dropping the number of complaints about door knocking. We were told that currently there are three complaints for every 1,000 doors knocked.



## 8. Prices and profitability

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The AEMC is required to look into prices and profit margins as part of the NSW Review. We asked respondents to comment on the level of price and profit (or ‘headroom’) in the NSW market right now. Our aim was to find out whether prices and profits are considered to be healthy and are an incentive for new entrants and vigorous competition. Or conversely, are prices and profits low because competition has eroded margins and for this reason retailers are not entering the NSW market. In the context of the level of prices in NSW, several respondents said that raised competitive markets are not just about lower prices but also about product and service innovations.

The objective of this exercise was to gauge perceptions rather than a quantitative analytical exercise.

### 8.1 Electricity

We found a clear distinction between the views of the incumbent retailers who are subject to price regulation and the other respondents we spoke to. The retailers who are subject to electricity and gas price regulation generally seem to consider the current levels of prices in the NSW markets reasonable. Their view is that there is sufficient headroom to operate efficiently in NSW.

One of the big retailers indicated that profitability in the market has diminished but that conditions in the market do allow it to make a return for its shareholders. This retailer explained that retail price increases are mainly due to higher network costs, the carbon price, and other green schemes. It said that the level of discounts it is offering has increased recently but that a softening of wholesale market prices in NSW has allowed it to maintain its profitability.

As relayed to us by this retailer:

*Discounts have gone up but prices have also gone up. But, in terms of, I would say, it's – our profitability is not much different because wholesale prices may have come down a little bit. Prices have gone up but it's mostly networks. So our head room on that part has gone down but our buying is a bit better. So, overall, we have been able to be quite stable in our business, to be able to consistently do that. But...it would appear over time that profitability has diminished...*

The view of this big retailer that profitability has diminished is consistent with the observation by another respondent. We were informed that some of the analysis of listed companies shows that they are not making particularly strong margins in the retail space.

On the question of profitability in the market, another one of the big retailers said that given the number of new entrants in the market it is a sign that it is commercially sensible for retailers to come to the NSW market.

In relation to the business segment, one of the new entrant retailers considers there to be an appropriate balance in the regulated standing offer for small business. This retailer said that

there is sufficient room in the regulated price above market prices and that this has allowed a reasonable level of competition.

This view is not shared by most of the other new entrant retailers operating in the market. Most new entrant retailers do not consider the level of profitability in either market to be healthy.

A typical view is reflected in the following comment by one of the new entrants:

*Very low on the small SME to residentials. The profitability is extremely tight. I would say very, very low, if anything - if any profit.*

One of the main points of concern is that the regulated price becomes the price to beat and retailers have concerns about the underpinnings for the setting of the regulated price in NSW. The point was made by several new entrants that they are competing against a 'theoretical efficient price' and that this conceptual underpinning is not the price that will encourage entry and competition in the market.

One of the new entrant retailers discussed the problem of having price regulation.

*...what competition does is it kind of sets the price at the party that's most efficient at delivering it, but that price includes things like...return on your investment, and so on. So in Victoria it's a market price. Unfortunately what we're competing against in New South Wales is a price that's not set around those sorts of parameters...it's set by some guy in a theoretical framework, and that then means that customers in New South Wales are less profitable. So, you know, therefore for many people that would seem a virtue, but what it means is that because you don't get the return that you need to make your business cases stack up in the long term, you don't get the investment that you need to make things happen in the long term either.*

Another new entrant retailer that is active in NSW explained that its decision to curtail marketing in the Ausgrid distribution area was because profitability was unacceptably low following the regulatory decision in July 2012. This retailer explained that the incumbents with standard contract customers have an advantage because they have standing offer customers who do not receive a discount.

This retailer explained that:

*We don't have the favoured position of an incumbent, where every customer they have, half of them they don't need to offer a discount to because they've never switched.*

This view was reiterated by another new entrant retailer that focused on residential customers. It was pointed out that to encourage customers to switch they need to offer a discount to all customers.

This retailer expressed particular concerns about the ability to offer discounts depending on the outcome of the 2013 pricing determination.

As expressed by this retailer:

*...discounting tariffs become very expensive when you've got large amounts of uncontrollable cost in the tariff...And then of course...the uncertainty at the moment about what's going to happen with the tariff re-set from July [2013], which could potentially squeeze again the controllable cost...For the retailer, particularly with the reduction in the wholesale cost*

*allowance, which again means there's just less headroom for retailers to offer something that's attractive enough to generate a switch.*

Several of the new entrant retailers said that cost factors such as acquisition costs and costs of bad debt affect their profitability. This in turn affects the level of discounts they can offer to customers.

In particular, credit worthiness of customers was an issue that several retailers raised. One respondent pointed out that retailers face the risk for the whole industry if customers default on their payment. The issue for this small retailer is that given the low margins in retailing, credit defaults is a significant problem.

As told to us by this retailer:

*...bad debt is massive for us. That's what kills us and you can just never factor that. So we get our 5 per cent margin share [referring to the regulated margin], however if that customer defaults on us ...we take that whole hit which erodes your [margin] pretty quickly. In other parts of the world, the network company would share that bad debt risk so if we didn't collect from that customer the network company wouldn't collect from us or be able to charge us. Wholesale you usually have to take the hit ...on but the green ... that's a government scheme. We are basically ... paying the government for that without receiving the cash. So 70 per cent of our bill, you could argue, that we're carrying the risk of the industry and only getting ... 5 per cent [margin]. But it's not cost reflective when we look at the retailers' skinny little margin on the end.*

Several retailers questioned the sustainability of the prices and profit levels in light of the large discounts being offered by the big retailers.

An inactive retailer was even less sanguine about the profitability in NSW. This retailer said that it is not operating in the NSW market because the profits were not adequate for it to enter. In the words of this retailer:

*So [profits are] not at... what we could consider reflective levels, you know, for an efficient retailer to make a reasonable rate of return on their investment for the cost and the risk they face to enter a market.*

The licensed but inactive retailers that are poised to commence operating are waiting on the outcomes of the next pricing determination in NSW. As with the inactive retailers, new entrant retailers are “anxiously” awaiting what IPART is going to do for the next three years.

## 8.2 Gas

There were fewer comments made about profitability in gas retailing. The main view is that the margins in gas are lower and this is the main reason why gas is not offered on a stand-alone basis but instead is bundled together with electricity. As shown in Table 2, a dual fuel offer usually has a slightly higher discount.

The lower margins mean that for retailers that actively retail gas this limits the ability to offer higher discounts. That is, there is less of an inducement that can be offered by retailers to gas customers compared to electricity. For inactive retailers, the lower margin together with the complexity of the gas market arrangements makes entering the gas market a more difficult proposition.

Our conclusion is that the level of prices set by regulation appears to have halted the entry and expansion plans of several new entrants in the NSW electricity market. Given the complementary nature of gas to electricity, the knock on effect of this is it has stymied the entry of retailers that would be offering a dual fuel product.

## 8.3 Price and incentives to innovate

During the course of the interviews many retailers said that the lack of profitability in NSW affected their long term ability to develop new products and introduce new business systems.

In particular, several respondents said the price regulation can contribute to stifling product innovation. The problem is the risk of insufficient headroom set by the regulator to provide an incentive for retailers to innovate and develop new products and services.

Another retailer said that the main difference between NSW and Victoria with regards to innovation is that retailers invest more heavily in Victoria than in NSW. The reason given for this is the constrained headroom in NSW.

This respondent said:

*They [retailers] invest more heavily in Victoria...relative to NSW because of the constrained headroom in NSW as a result of more recent regulatory outcomes on pricing.*

There was a view amongst respondents that being subject to a regulatory pricing regime where the terms of reference that set the boundaries for the reviews change for each of the three year reviews creates uncertainty. The uncertainty about the regulatory parameters and outcomes on pricing made decisions about investment in product innovation difficult – more difficult than if the price was being set by the market.

One respondent said that:

*...it's much easier to make those investments [on product innovations] in an environment where you've got confidence that you will get rational pricing outcomes and that ...you're making an investment in something that will help you compete in a market that has not got other sort of regulatory interventions laid out at the top. It's more difficult to do that in a market where you're at the mercy of regulatory pricing.*

Several retailers expressed frustration at what they consider to be limited headroom due to the short term focus inherent in regulatory processes. The typical sentiment is reflected in the following statement:

*...we want to invest in systems and innovate and do smart tools and in-home displays and make that type of investment which the kind of regulated determinations would never allow for because that's a 10, 20, 30 year type investment. Which if I was a network company, there's a mechanism – they could invest in anything they wanted and get a guaranteed 10 per cent return. However as a retailer, for me to innovate I have got limited funds to do it so I need to go to my shareholder. IPART has allowed me a 5 per cent margin. I want to spend \$20 million on a billing system. The answer is pretty quickly, "No," in most cases if it was just the New South Wales investment decision. So having Victoria I might get away but then I will say, "Well, you get more Victorian customers." So it's not just the customer investment. It's all the service and innovation that I want to go with it. It's the whole point that we're kind of here.*

There is a view that to operate successfully retailers need to develop products and services that continue to meet the expectations and demands of customers. There is general frustration felt by retailers, that the lack of headroom in NSW pricing prevents retailers, and in particular new entrant retailers, from being able to develop new products and services for the NSW market.

Therefore, the extent of future product and service innovations in NSW will be influenced by the outcomes of the 2013 review of regulated electricity retail tariffs.

## 9. Future market developments

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In the final set of questions we asked respondents to look ahead and propose options for regulatory price arrangements under two scenarios. Firstly, if the NSW Government decided to deregulate and remove price regulation, suggest how should this be done; and secondly, if the NSW Government decided to retain price regulation, to offer any alternative approaches to the form of regulation.

Respondents were asked to discuss their views about ways to enhance competition in the NSW market; the potential impact of NECF on the NSW retail markets and also on where electricity and gas retailing is heading in the next ten years.

### 9.1 Price regulation

#### 9.1.1 What if price regulation is removed?

We asked respondents to tell us their preferred approach or process for removing price regulation should the NSW Government decide to deregulate retail prices. Respondents tended to either support an immediate removal, or a clearly signalled transition path.

##### **“Just do it”**

At least six of the respondents have the view that there is no need for any transition or staggered approach to the removal of price regulation and prices could be deregulated with immediate effect.

A typical view is presented in the following comment:

*If you're going to do it, just do it. Let's not have any regulation and requirements around the process. We either have it or we don't have it. Just turn it all off one day.*

Several of these retailers acknowledge that removing price regulation without some form of transition may be too blunt an approach for the Government to take. On this basis there is support for a transitioning period prior to price regulation being removed. This acknowledgement is based on political realities facing the Government and not their views on the state of competition in the NSW market.

##### **Model for transitioning to deregulation**

As discussed, most respondents perceive that removing price regulation without some form of transition may not be acceptable to the Government for political reasons. If a transition to price deregulation were adopted, the majority of respondents strongly supported the NSW Government emulating the transitioning approach adopted in Victoria when price regulation was removed.

The Victorian approach is considered to have merit because the implementation process had gone smoothly and it was a proven model. A consistent theme from respondents is that Victoria is further ahead with market deregulation than other jurisdictions, and that on this basis other jurisdictions should draw on the lessons from Victoria.

A typical comment supporting the Victorian transitional approach to removing price regulation is as follows:

*[A staged approach] seems to work well in Victoria, and I think it's a proven model, and it's something that IPART can use as a stepping stone as well and keep an eye on, and have some control over it as well*

The features of the Victorian approach favoured by respondents include:

- The staged approach to transitioning to a deregulated market; small business customers were deregulated one year ahead of residential customers.
- Retailers are obliged to publish their standing offers.
- Standing offers are presented in unit prices.
- Hardship is addressed separately to pricing.

Several respondents noted that governments retain the ability (under the Australian Energy Market Agreement) to re-regulate prices if competition is not working. We were told by at least two retailers that during the phased deregulation of the market, the Victorian Government reminded retailers that it had the option of re-regulating if the market “failed”.

A typical view from the retailers is demonstrated in the following comment:

*...if the market for some reason failed, the government can step back in and re-regulate and that's actually very important to retain that ability and we've always encouraged governments "You should retain that ability". But governments shouldn't necessarily be in a commercial market setting prices. That's where it becomes skewed and not necessarily in their skill set.*

*But deregulating small business, then a year later they deregulated residential, they remain with the ability to re-regulate if things didn't work and so far down the track the Victorian market's held up worldwide as a great case study. So I don't see why they wouldn't just simply cookie cutter what happened in Victoria.*

There is some pessimism that politics may get in the way of adopting the Victorian approach in NSW:

*I suspect that the other jurisdictions won't because, I guess, as an observer there's the desire to do things differently in different jurisdictions.*

In the same vein same, several retailers pointed out that national consistency in regulation would be beneficial to the NEM. Two of the retailers suggested that national consistency on the standing offer arrangements would be good. This would include consistency on matters such as the time and frequency with which retailers can change the standing offers:

*I think the Victorian model works pretty well, so, you know, I kind of think, "Well, if we have a model, why reinvent something?"*

## **IPART's proposed opt-in model**

One retailer considers that the opt-in model proposed by IPART would enhance competition. Under IPART's proposed opt-in model, customers would need to actively choose to remain (“opt-in”) on regulated prices. IPART would regulate a limited number of

new cost-reflective regulated prices for each standard retailer (incumbent). IPART suggests that the introduction of this model would need to be accompanied by a comprehensive customer information and awareness campaign.<sup>23</sup>

One retailer viewed the opt-in approach as likely to stimulate those customers who are still on the regulated price to shop around, and “dip their toe” into the competitive market which in this retailer’s view will be of benefit to those customers and to retailers:

*They’re [customers on regulated prices] paying far more than they really need to, you know, and anything that a regulator who sets the retail price path could do to encourage customers, those customers, to finally enter the competitive market is a good thing. And it’s a good thing for those customers. And I think it’s a good thing for the broader market overall, because you’re expanding the size of the market, which provides a bigger playing field for retailers, so you will only get more competition as a result.*

Two of the big retailers considered that the opt-in model was a possible option to transition to a deregulated market.

Another retailer was not supportive of the proposed opt-in approach and considers that it will not enhance customer understanding of competition. This retailer expressed the view that the proposed opt-in model was a difficult message for people to understand:

*so you say to people, “well, you were on a regulated price before, now you’re on an unregulated price, but there’s going to be a regulated price over here, and if you want that you going to have to come back to it”....I think if you had this discussion about opt-in opt-out people are going to freak out.*

## **Clarity and consultation about price deregulation**

Several retailers considered that consultation with the industry is important in moving to a deregulated environment.

One retailer said that the key thing which relates to confidence in the marketplace is clarity about the removal of price regulation to ensure that the process occurs without the opportunity for reversion in policy. The retailer was referring to IPART’s proposed opt-in approach.

As explained by this retailer:

*We could live with that [proposed opt-in model] as an interim step but we would want to be quite clear that at a defined point in time that there is no regulated tariff and the simple reason for that is even if there is only a few customers on it, it effectively sets a ceiling and you do lose confidence in the regulator setting those tariffs...*

Further, this retailer referred to what it perceived as the uncertainty that occurred in South Australia where the regulator proposed to take \$30 a megawatt off the tariff.<sup>24</sup> As put by this

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<sup>23</sup> IPART 2012, *Review of regulated retail prices and charges for electricity 2013 to 2016 Electricity -Issues Paper*, November 2012, p.5.

<sup>24</sup> Refer to footnote 8 for background information.



retailer, even though only around 20 per cent of customers in South Australia are on the regulated tariff, the implications of reducing the price of the regulated tariff will affect the whole market.

This retailer strongly believes that transitioning to full price deregulation requires clarity and certainty and to ensure there is no opportunity for unexpected reversions in policy.

### 9.1.2 What if price regulation is retained?

We asked if there were a better approach to price regulation than the current arrangements. All respondents prefaced their response to this question with a statement that continued price regulation is not supported. Price regulation is seen as a second-best or sub-optimal outcome.

Increased AEMC involvement is considered to be an option if price regulation is to be retained. One retailer said that it supports the Standing Council on Energy and Resources (SCER) proposal for the AEMC to be responsible for determining a nationally consistent methodology for retail energy price regulation. Retailers supporting greater involvement of the AEMC did so because they considered the AEMC to be positioned better to balance the short term benefit to consumers and the long term impacts on generation investment.

For example, one retailer told us:

*If a generator can't get a profitable return because all they really do is sell to retailers, and if there isn't enough - if they can't pass their costs through then the generation won't get built.*

Although retailers saw a greater role for AEMC, retailers are generally happy with the way IPART conducts the pricing review processes. The pricing review process is generally considered transparent and rational. A number of retailers expressed positive sentiment about the current terms of reference for the price review, which explicitly state that continuing price regulation is to be underpinned by the principles of consumer protection and facilitating competition in the electricity market.

As relayed by one of the respondents:

*I think that the model of IPART is pretty good. I think that ... they're full time commissioners, [and a] full time chair. People with, you know, genuine economic backgrounds who can really look at the detail because it's complicated stuff. I think that's good. I think that the way that they are currently structured...in terms of reference, is okay because it does mean that, effectively, we've got a cap, not a price and I think that's important.*

One retailer said that setting regulated price paths for at least three years with no annual review would provide more certainty to retailers. In the view of this retailer, a three year approach under the current terms of reference was better as an annual review process creates additional risk.

Another retailer proposed that that some protection to avoid confusion for customers would be to standardise descriptions of units of charge. The obvious one is cents per kilowatt hours and cents per day.

## More head room

Several retailers stressed the need for the regulated price to be set at a level to provide sufficient head room for competition to occur underneath it.

These retailers share the view that IPART's approach to determining regulated prices is to base the regulated price on the tariff of an efficient mass market incumbent retailer. This efficient price approach is considered to result in a price level that is too low as it does not reflect the higher customer acquisition costs of a new entrant relative to an incumbent. The issue is that if the policy objective is to encourage new entrants into the market to drive competition benefits for consumers, then IPART's methodology does allow a new entrant to compete in the market.

As one retailer said:

*So ... to what end is the methodology being created for. So if you want to stimulate competition, pricing methodology should be something that stimulates competition. If you want to assume that it is the most efficient operator pricing, by definition that won't stimulate new competition because you have largely got a fixed view on what efficient costs should look like.*

## Light handed regulation

If price regulation is to be retained, several retailers expressed a preference for a more light handed approach to price regulation.

Several retailers suggested that if some form of regulatory intervention focused on pricing is to remain, a better approach would be a price monitoring type approach. These retailers argued that price monitoring would provide an opportunity for the market to work, while providing the Government with the information it needed to monitor results and potentially re-regulate if the market did not deliver the anticipated benefits for consumers.

If electricity pricing regulation is retained, some respondents prefer a light handed approach such as the Voluntary Transitional Pricing Agreement (VTPA) that applies in gas. As explained to us:

*The VTPA is a more light-handed framework than the regulatory determination process for electricity. The light handed approach is clearly preferable to what is considered a highly intrusive process that is conducted in going through and attempting to model the various methodologies of the wholesale energy cost. This is in contrast to a sort of propose respond model in gas. A light-handed model if we have to have price regulations clearly would be better to the current approach in electricity.*

It was noted however that the VTPA in gas has been around for so many years that it is no longer 'transitional'.

### 9.1.3 Definition of small customers

To assist the transition to an effective competitive market, the NSW Government has indicated that it will change the definition of small retail customer for the purposes of price

regulation from customers using less than 160 MWh of electricity per year to customers using less than 100 MWh of electricity per year.<sup>25</sup>

We asked respondents whether this is a practical approach to reducing price regulation and to consider impacts in the markets. In general, lowering the threshold for defining small customers is considered a reasonable approach but only as a way to transition to full price deregulation.

At least four retailers expressed ambivalence about such a transitional measure and considered that it was not necessary. It was explained that the average residential consumer in NSW consumes around 7 MWh per year which is a long way from 100 MWh per year.

One retailer said:

*So the 160 to 100 is very much a small business change, and I mean, arguably, if you're using 100 megawatt hours, you're a reasonable size small business. But...is it a form of price deregulation? Yes, we would agree it would be and maybe politically, it's a more palatable way to do it. But our preference would be, you know, to do what Victoria has done.*

A lower threshold is preferred by several other retailers. A typical comment was:

*if you could reduce the threshold down to 20 megawatt hours to provide any regulatory price protection, that would help, because again, it opens up another part of the market in the small business market that allows retailers to compete and get those economies of scale and have that certainty when contracting for those customers.*

The view of one retailer was dependent on whether the NSW Government was committed to full price deregulation or not. If there is a clear commitment and process for deregulating within a fixed timeframe then this staged approach would be acceptable. Ultimately, however, this retailer considers that there is enough competition in NSW to not require a staged approach at all. This retailer prefers that there be no price regulation at all.

Another retailer, while supportive of changing the definition of small customer, envisaged administrative challenges with trying to identify whether a customer is at the 100 MWh per annum threshold. Other retailers said that the threshold should be much lower say down to 20 to 25 MWh per annum.

Another retailer simply wanted national consistency on any definition of small customers for the purpose of price regulation.

## 9.2 Views on enhancing competition

We asked respondents their views on ways to enhance competition in the NSW retail electricity and gas market - either with or without price regulation in place.

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<sup>25</sup> The terms of reference can be found at [http://www.ipart.nsw.gov.au/Home/Industries/Electricity/Reviews/Retail\\_Pricing/Review\\_of\\_regulated\\_electricity\\_retail\\_tariffs\\_and\\_charges\\_2013\\_to\\_2016](http://www.ipart.nsw.gov.au/Home/Industries/Electricity/Reviews/Retail_Pricing/Review_of_regulated_electricity_retail_tariffs_and_charges_2013_to_2016)

## 9.2.1 Retail price regulation

Respondents typically took the opportunity to restate their view that regulatory risk posed by the existence of price regulation is holding back the development of a more competitive market. There is a strong view that the removal of price regulation would enhance competition. Price regulation is viewed as being more detrimental than beneficial to the effectiveness of competition.

Price regulation is viewed as an impediment to new entrants coming into the market and to the expansion strategies of active retailers, in particular, for the new entrants. Pricing intervention is seen as inhibiting product and service development given that most offers in the NSW market have been a discount off the regulated tariff, and raising the risk of long life investments, including generation.

A typical comment that reflects the concerns about pricing intervention that has taken place in several other jurisdictions is as follows:

*I think the removal of price regulation would definitely help, because it just takes the risk away. You know, we've seen this big jackboot, frankly, down on the ... Queensland market which has seen people exiting in droves. There's a concern about South Australia for the same reason. It's pretty hard for governments to manage regulators and it's pretty hard for regulators to manage governments. So if you've got two sources of regulatory risk in a ... sort of price capping process, it's twice as risky and, consequently, you know, I think there's a genuine risk whilst we have that structure.*

## 9.2.2 Wholesale market developments

Several retailers expressed concern about the wholesale market arrangements. Smaller retailers especially are concerned about the potential for more vertical integration as an outcome of the NSW Government's proposed sale of the Government owned generators.

Smaller retailers are hoping for more independence and diversity of ownership in the NSW generation sector. As expressed by one retailer when asked about ways to enhance competition in NSW:

*Ensuring that Macquarie Generation doesn't go to AGL or Origin and not TRU, quite frankly. You know, retaining some sort of independence in ...generation. More diversity in ownership.*

However, another new small retailer thinks that the potential sale of the NSW generators will have little impact on its ability to obtain hedge cover because the books of the retailers that own generators ('gentailers') will never be perfectly matched. This means that the gentailers will be willing to provide hedge cover to other retailers.

Overall, however, retailers perceive access to the wholesale market as a lower order problem relative to the uncertainty of price regulation in the retail market.

## 9.3 National regulatory framework (NECF)

NECF is scheduled to commence in NSW on 1 July 2013. We asked respondents what impact introduction of the NECF is likely to have on the NSW retail markets.

The NECF is, for the most part, seen by respondents as an important initiative to improve the national character of the national market and to provide a harmonised and consistent set of rules for the retailers. Each of the retailers we spoke to operate in more than one jurisdiction and consistency is considered to be an important factor for simplifying their processes and compliance requirements. We were told it will make operating across jurisdictions much more cost effective. Retailers, for the most part, are hoping to see a national consumer framework implemented and not “cynically killed”.

Needless to say, the stalled implementation of NECF in NSW and other jurisdictions drew strong criticism from the retailers we spoke to. Several respondents described the NECF process as a “debacle” that has increased costs to retailers. Several retailers said that they have invested a considerable amount of money to bring some sort of homogeneity to processes only to find that the money was lost.

We asked one retailer how much it had cost to work on the implementation of NECF. This retailer is a second tier retailer in Victoria and an active retailer in NSW. This retailer estimated, roughly, that it had spent around \$2 million on NECF-related costs to date:

*I was going nearly two million with my estimate...Easily, with all of the contractors and planning and business requirement documents...Just the contractors, that's the real killer. It's not so much the system implementation. If you go back to see what the system enhancement – that might be only a million.*

The other cost was the opportunity cost of other developments and improvements coming through the pipeline. These other developments were prioritised back down to pipeline so as to prepare for NECF.

Despite the problems of the previous policy process, the majority of interviewed retailers support and want a nationally consistent consumer framework.

*I would say that a national electricity market would have to have far more consistency of doing things, you know. And it's going to happen. It has to happen.*

Another retailer said:

*I think harmonisation is a good thing. I think reducing the derogations over time will be important, so they actually do get to a standardised framework, but the more we can do to standardise, the easier it will be for retailers to implement and that is cost - less costly and it results in less complaints, so it's got to be a good thing.*

The view is that, if implemented nationally, NECF will be positive and will make things easier for business.

A retailer that operates across seven jurisdictions was desperate for State and Territory governments to implement NECF as it would make operating its national operations much more streamlined: Similarly, another retailer that operates in a number of jurisdictions except NSW, said that

*...across our whole business we have 200 reports that we need to provide to the regulators each year. You know, it's an enormous burden and enormous expertise that is required for you to be in retail. You know, whether you're a customer in NSW or in South Australia, governments should want to protect you in the same way. You know, there shouldn't be any difference at all.*

## 9.4 Ten years from now

We asked retailers to look ten years into the future and describe what the retailing energy industry will look like.

### 9.4.1 Entry or exit of participants

A small retailer said that it was hoping there will be new player in generation when the NSW Government sells its generation assets. This retailer was hoping for a US, UK or Asian owner because having a new player to trade with would be beneficial to a retailer such as itself.

We were also told that there is a possibility that within 10 year some of the second tiers may exit the market. The reason given for this is because of things like NSW pricing regulation and the price freeze in Queensland has had a hugely detrimental impact on several companies operating in NSW.

Quite a few of the respondents talked about new types of energy retailers emerging in the industry that will challenge the traditional model of retailing. In particular, respondents expect the emergence of more energy efficiency providers who will offer a retail contract as a part of their bundled service. Several respondents noted the emergence of solar PV providers who are entering the retail market as part of their product and service offerings to customers.

One retailer that operates in this new area considers the traditional mode of discounting was "almost dead". This retailer said:

*So I think that the old retail model - I would go so far to say as the retail model is almost dead in Australia. You've got a limited number of customers and you're competing on discounts. Everybody at the moment wants you to use more because they get more revenue and your revenue is based on usage. It's killing some of the retailers when consumers are using less and less and that's been the steady trend.*

Another retailer considered that brokers would become more prevalent in the market as customers were looking for someone to trust and to assist them in understanding the deals on offer.

### 9.4.2 Technology and new modes of retailing

Technology is seen to be one of the biggest influences shaping the industry in the next ten years. New technology is seen as game changing in the energy sector and will change the way the market operates. Some of the 'megatrends' that were mentioned that might radically re-shape the sector included micro-generation, large scale storage, electric cars, solar, smart metering and associated devices.

Several retailers advocate a market led roll out of smart meters in NSW. None of the respondents that we spoke to about smart meters advocated the Victorian approach for a mandated distributor led roll out of smart meters.

We were told that the proliferation of smart devices by virtue of falling costs will enable customers including the ‘mums and dads’ to temper their energy consumption. The view is that new devices will help to shift customers’ energy use and will probably lead them to use less energy on average. This reduction will also be achieved through stricter building codes and energy efficiency ratings for housing.

As explained to us:

*...the price of the devices are coming to a point where they can be useful. You know, even when we started the market here, the smart meter was quite expensive and the communication stuff on there was quite expensive. The price is dropping dramatically, you know, and energy efficiency stuff is certainly, you know, starting to be effective. Some of those things are causing...genuine changes in demand.*

The prevalent view in the industry is that through new technology customers will be more informed and seek to manage their electricity usage through enhanced access to consumption information.

Several retailers envisaged that the industry will shift away from the traditional model we have today to one a more integrated energy model.

This retailer talked about changes in the next five years:

*You could wind it forward five years where you can imagine seeing this is where I plug my car in at night and I charge it up and I'm feeding energy back into my house and I can run my dishwasher off that energy...*

Quite a few of the respondents mentioned that the traditional model of energy retailing was on the wane. These respondents saw new types of businesses emerging that were offering energy services or a more integrated type service for customers. We heard from several retailers that, in response to customer demand, they see their role in the future will be to help customers with that experience and provide home management services and become a whole of energy service provider.

## Appendix 1 Retailers and Associations invited to participate

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1	ActewAGL Retail Ltd
2	AGL Sales Pty Limited
3	Alinta Energy
4	Aurora Energy Pty Ltd
5	Australian Power and Gas Pty Ltd
6	Blue NRG
7	Click Energy
8	Diamond Energy Pty Ltd
9	Dodo Power and Gas Pty Ltd
10	EnergyAustralia Pty Ltd (formerly TRUenergy Pty Ltd)
11	Energy Retailers Association of Australia
12	Energy Supply Association of Australia
13	ERM Power Retail Pty Ltd
14	Go Energy Pty Ltd
15	Lumo Energy (NSW) Pty Ltd
16	Momentum Energy Pty Limited
17	Origin Energy Electricity Limited*
18	Powerdirect Pty Ltd (owned by AGL)
19	QEnergy Limited
20	Red Energy Pty Ltd
21	Sanctuary Energy Pty Ltd
22	Simply Energy



## Appendix 2 Questionnaire to retailers

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### Introduction

The Australian Energy Market Commission (AEMC) is conducting a review into the effectiveness of competition in the small customer<sup>26</sup> electricity and natural gas retail markets in NSW (NSW Review). So far, the AEMC has conducted similar reviews in Victoria, South Australia and the ACT.

As in previous reviews the AEMC considers that energy retailers are a crucial source of information for the AEMC retail competition reviews. To help inform the NSW Review, the AEMC has commissioned Sapere Research Group (Sapere) to conduct interviews with retailers that are licensed to operate in NSW. The Sapere project team conducting the interviews will include Kieran Murray, Nives Matosin and Eli Hefter.

We have prepared a list of questions to be raised at the retailer interviews. The questions cover electricity and gas markets. The key themes to be covered in these interviews include:

- perceptions of competitiveness in the NSW small customer electricity and natural gas retail markets — including retailer rivalry, marketing activities and customer switching
- catalysts and barriers to entering, expanding existing operations or exiting the market
- likely impact(s) of removing retail price controls in the small customer electricity and natural gas retail markets of NSW.

The interviews process will include:

- one-on-one interviews with Sapere personnel. Comments made in the interview will be treated as confidential and shared only with the AEMC
- recording of the interviews, pending agreement from the participants in the interview
- transcription of the recorded interviews. The interview transcripts will be provided to the AEMC. The transcripts will be treated as confidential and will not be published
- interviews are scheduled for around one to one and a half hours, depending on the scope of responses.

We will prepare a report for the AEMC that will be published on the AEMC's website. The report may contain comments made during the interviews. The comments will not be attributed to any person or organisation.

The list of questions for the NSW Review is set out in this document. The questions are intended as a guide only and we will adapt questions to suit different retailer situations as required. If there is anything that you think of and wish to convey after the interview, you are welcome to contact Nives Matosin at any time. Nives can be contacted on 02 9234 0214; mobile 0406 537 608; and by email [nmatosin@srgexpert.com](mailto:nmatosin@srgexpert.com).

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<sup>26</sup> Under 160MWh pa for electricity and under 1TJ pa for natural gas.

## Interview questions

### Permission to record the interview

Firstly, thank you for participating in this interview. It would be very useful to have a recording of this interview. Do we have your permission to record this interview?

### Company background

1. Could you please introduce yourself and your role in the company?\*
2. Can you provide an overview of your company's activities? The things we are interested in include:
  - (a) Do you have an electricity and/or gas retail licence in NSW?
  - (b) How long have you held a licence(s) in NSW?
  - (c) When did you start retailing electricity and/or gas in NSW?
  - (d) Do you have electricity and or gas licences in other states?
  - (e) Do you retail to small customers?
  - (f) Approximately how many customers do you have? (small customers and total customers)\*
3. Can you tell me which locations within NSW you retail in? That is, do you retail across all NSW, or, in specific areas such as urban; regional or rural areas.
4. If you operate in other States, are there any similarities or differences between how you operate in NSW and how you operate in other states (if any)?
5. Does your company own electricity generation or gas wholesale operations?
6. In general, what are your company's plans in terms of the NSW market? Are you looking to stay / start operating / expand / change strategy / exit?

### Perception of the NSW electricity and gas retail markets

7. How would you describe the nature of competition (in terms of retailing activity and customer activity) in the NSW electricity and gas retail markets?
8. Approximately, what market share does your organisation currently have of the NSW electricity and/or gas markets respectively?
9. How has your market share changed since full retail competition; or since you entered the market? Have any expectations about market share been met?
10. Who do you consider to be your main competitors in the electricity and/or gas markets?

11. Do you know what the market share is of other retailers in the market? Do you monitor this type of information?
12. Have you been able to discern any changes in the market since the privatisation of the three NSW government owned retailers?

## Competitiveness and retailer rivalry

Here we will be asking questions about the electricity and gas markets separately.

### Electricity market

13. On a scale of 0 to 10 (where 0 means not at all competitive and 10 means extremely competitive) how would you rate the NSW electricity market in terms of competitiveness for small customers?
  - (a) What makes you say this?
  - (b) How has this changed over time?
14. How would you describe the level of competitive rivalry between retailers for small customers in the NSW electricity market? Is there a difference in the extent of rivalry between urban and regional areas?
15. Which retailers do you consider are most actively competing or seeking to retain customers?
16. On what basis are retailers competing? Is it on:
  - (a) Price or discounts?
  - (b) Level of customer service?
  - (c) Type of products?
  - (d) Tariff designs such as time of use pricing?
  - (e) Other incentives?
  - (f) Other offers?
  - (g) What evidence have you seen of this?
17. To what extent is there price rivalry between retailers?
18. To what extent is there non-price rivalry between retailers?
19. What are the most important factors for competing for the different customer segments (say for residential versus small business; urban and regional customers)?

### Gas market

20. How would you describe the level of retailer rivalry for small customers in the NSW retail gas market? Is there a difference in the extent of rivalry between urban and regional areas?

21. On a scale of 0 to 10 (where 0 means not at all competitive and 10 means extremely competitive) how would you rate the NSW gas market in terms of competitiveness for small consumers?
  - (a) What makes you say this?
  - (b) How has this changed over time?
22. Which retailers do you consider are most actively competing or seeking to retain customers?
23. On what basis are retailers competing? Is it on:
  - (a) Price or discounts?
  - (b) Level of customer service?
  - (c) Type of products?
  - (d) Tariff designs such as time of use pricing?
  - (e) Other incentives?
  - (f) Other offers?
  - (g) What evidence have you seen of this?
24. To what extent is there price rivalry between retailers? High – low?
25. To what extent is there non-price rivalry between retailers? High – low?
26. What is the most important factor for the different customer segments (say residential versus small business)?

## **Exercise of market choice by customers**

### **Electricity market**

27. What is your view about customer understanding and awareness of full retail competition and their ability to choose their electricity retailer?
28. What is your general view about customer willingness to switch retailers and switch from regulated to market contracts?
29. What are your observations about switching trends in the NSW over the past few years? In particular:
  - (a) Switching retailers
  - (b) Switching from regulated to market contracts.
30. What do you believe are the current levels of switching amongst small consumers in the NSW? A high level of switching; a moderate amount, a little, or none at all
31. Are there any differences in switching amongst domestic versus small business customers? What about regional versus urban customers?

32. What do you believe are the main drivers behind customers switching in NSW?
33. Are there any differences between domestic, small business customers, and more specific customer segments?
34. What do you believe are the main barriers/impediments to NSW electricity customers switching?
35. Do you know about how many small customers are on market contracts relative to the total number of small customers?
36. Are you aware of any customers returning to the regulated retail price? Why do you think this has occurred?
37. Do you think any customer types have less access to competitive electricity offers than others? [For instance: those with special needs, domestic versus small business consumers, pensioners, those from a non-English speaking or different cultural background, low income etc.] How do you market to these customers?

## **Gas market**

38. What is your view about customer understanding and awareness of full retail competition and their ability to choose their gas retailer?
39. What is your general view about customer willingness to switch retailers and switch from regulated to market contracts?
40. What are your observations about switching trends in the NSW over the past few years? In particular:
  - (a) Switching retailers
  - (b) Switching from regulated to market contracts.
41. What do you believe are the current levels of switching amongst small consumers in the NSW? A high level of switching; a moderate amount, a little, or none at all
42. Are there any differences in switching amongst domestic versus small business customers? What about regional versus urban customers?
43. What do you believe are the main drivers behind customers switching in NSW?
44. Are there any differences between domestic, small business customers, and more specific customer segments?
45. What do you believe are the main barriers/impediments to NSW electricity customers switching?
46. Do you know about how many small customers are on market contracts relative to the total number of small customers?
47. Are you aware of any customers returning to the regulated retail price? Why do you think this has occurred?

48. Do you think any customer types have less access to competitive electricity offers than others? [For instance: those with special needs, domestic versus small business consumers, pensioners, those from a non-English speaking or different cultural background, low income etc.] How do you market to these customers?

## **Barriers to market entry, expansion or exit**

### **Electricity market**

49. For your company, what are/were the main reasons or catalysts for you to enter the NSW small customer market for retail electricity?

#### **For retailers that are active in the electricity market**

50. Did your company experience any barriers to entry before commencing retailing in NSW? If so, what were they?
51. In your experience are there any barriers or impediments to expanding your retailing activities in the NSW market? If so,
- (a) What were/are the main barriers or impediments?
  - (b) Which are the most important/ most onerous?\*
  - (c) How can these impediments be removed or reduced?
52. We are interested in finding out about any differences in the barriers that may exist between urban and regional areas. Are there any barriers that are specific to regional markets? If so,
- (a) What are they?
  - (b) Are historical tariffs an issue?

#### **For retailers that are not active in the electricity market**

53. What are the main barriers to entry/retailing for your company? For discussion:
- (a) Wholesale market and hedging arrangements?
  - (b) Prudential requirements?
  - (c) Regulated retail prices?
  - (d) Compliance with environmental schemes?
  - (e) Unpredictable costs, for example costs associated with small-scale technology certificates?
  - (f) Other?
54. Are you considering retailing in the future? Under what conditions would you would enter?
55. What can be done to remove or reduce any barriers to entry and retailing?

**For all retailers**

56. Are economies of scale necessary or important to be competitive in the NSW retail market?
57. How many customers are required to make retailing operations viable?
58. Is vertical integration, such as with generation assets, necessary or important to be competitive in the NSW retail market?
59. Why do you think some companies may choose to exit the NSW market?
60. What are the costs and issues associated with exiting? Are there exit barriers that might dissuade entry?

**Gas market**

61. For your company, what are/were the main reasons or catalysts for you to enter the NSW small customer market for retail electricity?

**For retailers that are not active in the gas market**

62. Are there barriers to entering the NSW gas market? If so, what are the most important reasons?
63. What are the main barriers to entry or retailing/competing? For discussion:
  - (a) Wholesale market arrangements
  - (b) Access to gas supplies?
  - (c) Prudential requirements?
  - (d) Regulated pricing arrangements?
  - (e) Other?
64. Are you considering entry to gas market? Under what conditions would you enter?
65. What can be done to remove or reduce any barriers to entry and retailing?

**For retailers that are active in the gas market**

66. For your company, what are/were the main reasons or catalysts for you to enter the NSW small customer market for retail gas?
67. Did your company experience any barriers to entry before commencing retailing in NSW? If so, what were they?
68. Are economies of scale necessary or important to be competitive in the NSW retail gas market?
69. How many customers are required to make entry/operations viable?
70. Is vertical integration, such as with ownership of wholesale gas businesses necessary or important to be competitive in the NSW retail gas market?

### **For all retailers**

71. What can be done to remove or reduce any barriers to entry and retailing?
72. Why do you think some companies may choose to exit the NSW market?
73. What are the costs and issues associated with exiting the market?
74. What have you observed in terms of retail companies expanding or contracting in the offering of dual fuel products?
75. To be a viable retailer in the future will it be necessary to offer both electricity and gas?  
Or other products?

### **Your products**

76. The AEMC has asked that we collect three examples of product offers for new customers. Can you provide us with your current products (for electricity and/or gas)?
77. What products do you current offer in the NSW retail electricity and/or gas markets?
  - (a) How has the number and type of product offers changed over time?
  - (b) Have these changes been due to competitive pressures (consumer led), or have they been due to other market factors (for example, government policies)?
78. Which of your products and services are most popular? What aspects are customers attracted to? Why?
  - (a) How has the popularity of products changed over time?
  - (b) What do you think has driven these changes in popularity?
79. Do you currently offer any Time of use/dynamic tariff based products/services to small customers? If so, how many? If not, why not?
80. Are there any risks associated with offering time of use tariffs? Are there any benefits?
81. What have the take-up rates of time of use products/services been?
  - (a) Does it vary by customer class?
  - (b) Is it location based?
82. Do you believe there has been any impact on competition as a result of time of use offerings?
  - (a) Going forward, what impact do you think time of use offerings will have on competition in NSW (if any)?
83. What is the extent of product innovation and proliferation in the NSW retail electricity/gas market?
  - (a) How has this changed since the introduction of FRC?
  - (b) How do you think it will change going forward?



## Dual fuel products

84. Does your company offer a both electricity and gas products?
- (a) Is it a bundled product/contract or two separate products/contracts? Do customers receive a single bill or separate bills?\*
85. How important is it to be able to offer both electricity and gas products in the NSW market? For instance in terms of:
- (a) Branding
  - (b) Reduced costs
  - (c) Convenience to customers
  - (d) Being able to compete with other retailers that offer dual fuel products.
86. Are there barriers or impediments to offering a dual fuel product?

## Your marketing activities

87. What are your target markets?
- (a) Do you have a preferred customer profile? What is this profile? Are you able to accurately target this group? Has customer targeting changed over time?
  - (b) Are there any types of customers that you do not target? If so, what are the reasons for this?
88. What marketing strategies and channels do you find work best in the NSW retail electricity and /or gas market?
- (a) What channels do you use?
  - (b) How important is door knocking?
  - (c) To what extent do you use social media? Do you think there is an increasing role for social media channels going forward?
89. Are you required to spend time educating customers about their ability to choose their retailer?
90. Do you consider that a company needs to spend a lot of money on marketing to compete in the NSW market?
91. How do your customer acquisition costs in NSW compare to other states?
92. Do you expect your marketing in the NSW retail electricity/gas market will change in the future? Why or why not?
93. What are your views about the likely impact of the Federal Court's recent decision on door knocking in *ACCC v Neighbourhood Energy* (27 September 2012).
94. What are your views about the impact of consumer protection measures on competition?

95. What types of complaints that you receive from your customers. Have the types of complaints changed over time? What processes do you have to address the complaints?\*

## Prices

The AEMC intends to prepare an analysis of retail prices over time and have requested that we ask retailers for their past tariffs. Are you able to provide the AEMC with your historical tariffs?\*

96. How would you describe the level of prices and profitability in the NSW electricity market?
97. How would you describe the level of prices and profitability in the NSW gas market?

## Future market developments

98. In terms of the future:
- (a) Do you think that any new players are likely to enter the NSW retail electricity/gas market for small consumers within the next few years?
  - (b) What sort of companies do you think are likely to enter and succeed?
  - (c) Do you foresee any players exiting the market?
  - (d) What impact will the recently announced proposed sale of the NSW State-owned generators have on competition, if any?
99. Are smart meters likely to have an impact on competition in the market?\*
100. What changes do you believe are needed to take place to make the NSW retail electricity/gas market more competitive?
101. If the NSW Government decides to remove price regulation, what would you like to see happen in terms of the process or way in which retail price regulation is removed?
102. If the NSW Government decides to retain price regulation:
- (a) is there a more efficient approach to regulation than the current arrangements?
  - (b) what other options are there for enhancing competition in the NSW retail electricity/gas market?
103. To assist the transition to an effective competitive market, the NSW Government has recently changed the definition of *small retail customer* for the purposes of price regulation from customers using less than 160 MWh of electricity per year to customers using 100 MWh of electricity per year.
- (a) Do you think this is a practical approach to reducing price regulation?
  - (b) What do you consider will be the impacts in the electricity market?

104. What impact is the National Energy Customer Framework likely to have on the NSW retail markets?
105. What do you think the NSW retail electricity/gas market will look like 10 years from now: What issues do you expect may impact on competition in the future?
106. Are there any other issues that you wish to raise?

### **Conclusion of the interview**

Thank you again for participating in this interview.

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