

8 February 2013

Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales
Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

By email: aemc@aemc.gov.au

Dear Sir/Madam,

RE: Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales

The Energy Retailers Association of Australia (ERAA) welcomes the opportunity to provide comments on the Australian Energy Market Commission's (AEMC) *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales Issues Paper* (the Issues Paper).

The ERAA welcomes this review, and believes its findings will provide timely evidence that will support the deregulation of energy retailing in NSW.

The ERAA represents the organisations providing electricity and gas to almost 10 million Australian households and businesses. Our member organisations are mostly privately owned, vary in size and operate in all areas within the national electricity market and are the first point of contact for end use customers of both electricity and gas. Of particular relevance to this review is the ERAA's unique insight into what drives a new entrant (sometimes referred to as a "second tier") retailer to enter a market and compete for customers. A number of our members do not currently have a significant customer base in NSW but are likely to be attracted to the market if clear direction is set by the AEMC and NSW Government on phasing out retail price controls.

Under the *Competition and Consumer Act 2010 (Cth)*, the ERAA is not permitted to share or discuss information within the Association in relation to prices and the mechanisms for setting prices. As the Issues Paper seeks detailed operational information from individual retailers, the majority of the questions contained in the Issues Paper are not suitable for ERAA comment. The ERAA will focus its input on broader policy issues, referring to the individual submissions of our members for more specific input, and we strongly recommend that the AEMC has due regard to these submissions. The ERAA has already actively participated in this review, providing verbal and written evidence to Sapere, the consultants commissioned by the AEMC. The comments contained in this submission reinforce that evidence.

The state of competition in NSW – effective for small energy customers

The ERAA agrees with the Independent Pricing and Regulatory Tribunal of NSW's (IPART) preliminary view that competition in the NSW retail electricity market has increased since 2010.¹ The ERAA believes that this increase in competition has brought related benefits to customers in NSW, as retailers strive to improve their price and service in an effort to obtain new customers and retain current customers.

¹ IPART (2012), *Review of regulated retail prices and charges for electricity 2013 to 2016 Electricity - Issues Paper*, p.24.

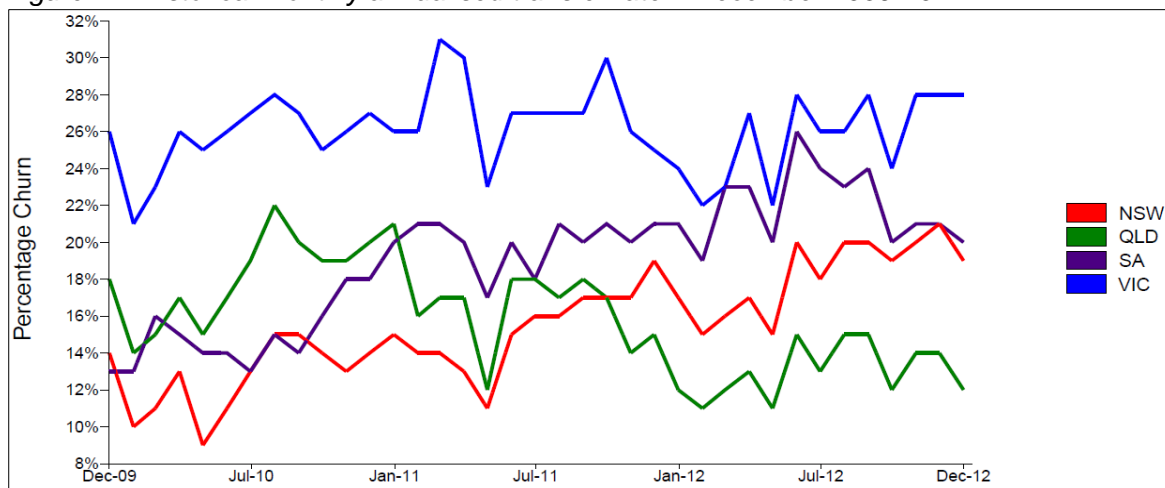


Outlined below are customer switching statistics demonstrating the significant improvement in competition in NSW over recent years. Whilst switching statistics are not the sole metric to measure competition, research shows that globally, markets with high switching rates can experience greater levels of service and benefit from better product differentiation.

Customer switching behaviour - electricity

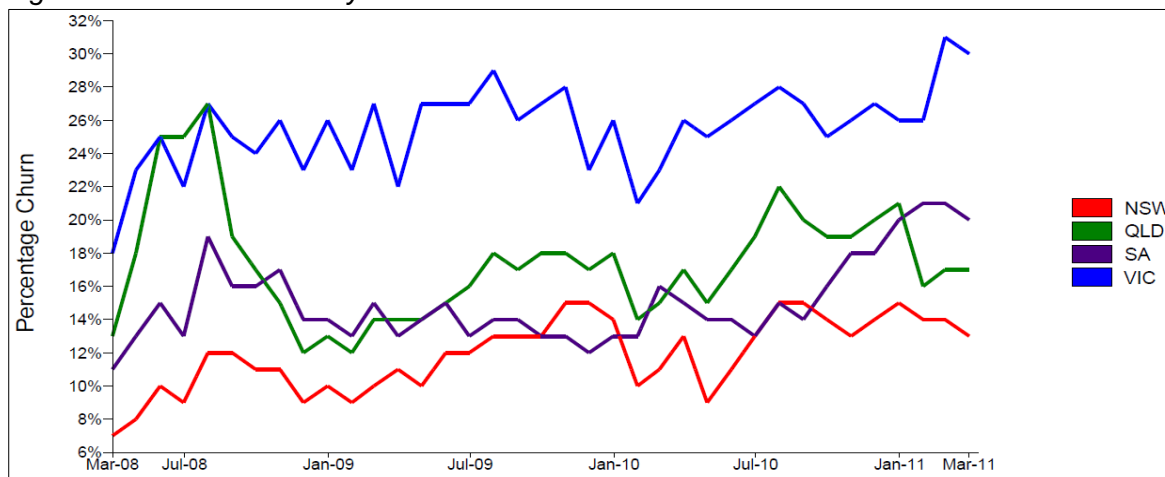
As outlined in AEMO's National Electricity Market Monthly Retail Transfer Statistics December 2012, and summarised in Figures 1 and 2, the level of switching in NSW has been increasing at a steady rate since early 2008. In under five years, this rate has risen from around 7% to 19%, making NSW one of the most active switching markets in the world.

Figure 1 – Historical monthly annualised transfer rate – December 2009-2012



Source: AEMO, 2012

Figure 2 – Historical monthly annualised transfer rate – March 2008-2011

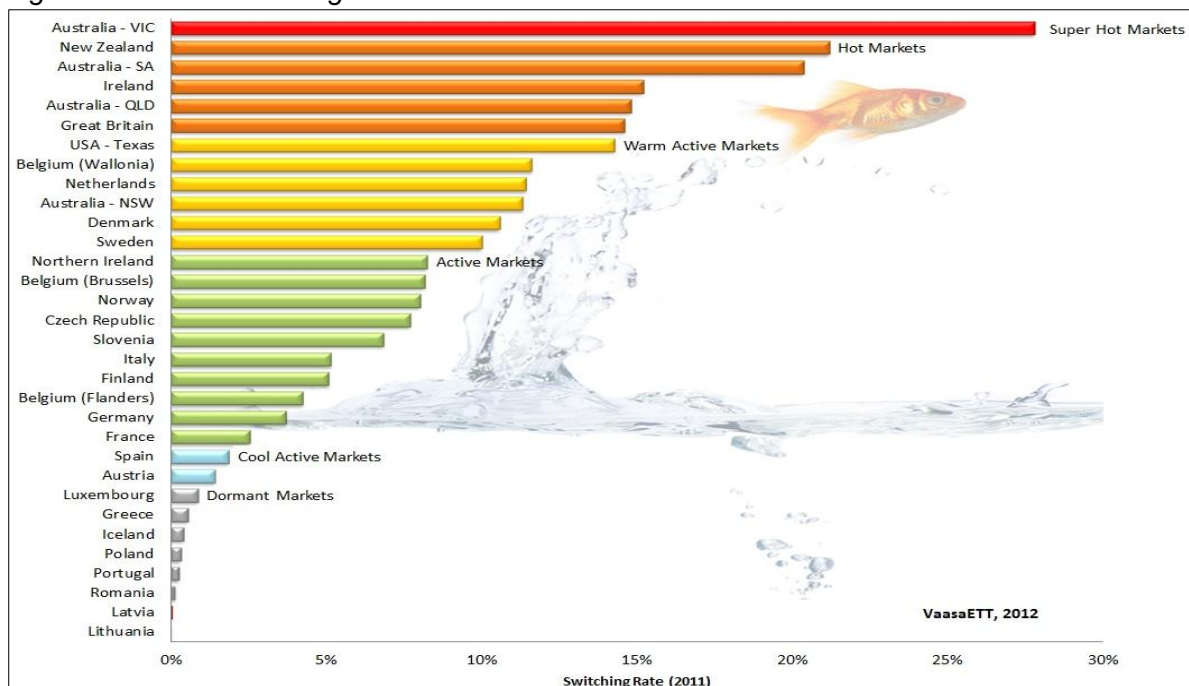


Source: AEMO, 2011

In addition to these figures provided by AEMO, the ERAA refers the AEMC to global switching statistics provided by energy think tank VaasaETT. In the VaasaETT's most recent global summary there were only three markets with switching rates over 16%.²

² VaasaETT (2012). World Retail Market Rankings 2012.

Figure 3 – Global switching levels - 2011



Source: VaasaETT, 2012

The trend displayed in switching rates in NSW, and in particular July through to December 2012, would be categorised by VaasaETT as a ‘hot market’.

Customer switching behaviour - gas

Whilst switching levels for gas markets are lower than for electricity, they exhibit a similar upward trend. The total volume of monthly consumer transfers in NSW rose from 8,518 in September 2010 to 19,272 in December 2012, with the annual percentage switching rate rising from 9% in September 2011 to 14% in December 2012.³ Despite competition being relatively more effective for electricity than gas, retailers will continue to seek gas customers as part of their dual fuel marketing strategies.

Deregulated retail energy markets

Although the focus of this review is to assess the effectiveness of competition in NSW, it is important to acknowledge the experience of those markets already deregulated.

Victoria

Victoria phased out regulated retail prices on 1 January 2009 following the advice of the AEMC that competition was effective. Since then, competition has developed strongly; offering customers more diverse and innovative energy products, and enabling consumers to save on their power bills by shopping around. Victoria’s market is the most active in the world, with switching rates being consistently greater than 25%. This is substantially more than the other markets in the NEM which have not yet deregulated retail energy prices. Furthermore, the Victorian market has the least concentrated market share in Australia, where non-incumbent retailers have been able to secure one quarter of the market.

³ AEMO (2012) NEM Monthly Retail Transfer Statistics – September 2011 – December 2012.

South Australia

Given the recent deregulation of the South Australian market, the ERAA recommends the AEMC monitors activity as part of this review. The ERAA anticipates that price deregulation in South Australia will precipitate more intense competition between retailers.

Importance of deregulation for NSW

The ERAA has consistently advocated for deregulation of the retail energy market to drive the best outcomes for consumers. Open, competitive energy markets free from distortions such as retail price regulation naturally encourage prices to be efficient through the development of market offers. Competition in retail energy markets, as in other sectors of the Australian economy, incentivises businesses to improve service, develop products that meet consumer needs and find ways to lower their costs and to pass these savings onto consumers. Price regulation is an oddity in the Australian economy as it doesn't apply to almost all other contestable goods and services such as food, fuel, telecommunications, insurance and housing. As concluded by the AEMC in their 2008 assessment of competition in Victoria,⁴ the ERAA believes that the removal of retail price regulation in NSW can further extend the benefits of competition to consumers.

As noted by IPART, retail price regulation cannot protect customers from general financial stress.⁵ Much of the increase in energy prices over recent years has been due to higher cost factors outside retailers' control, and again IPART notes that price regulation does not protect customers from the price shocks associated with changes in regulatory and policy settings.⁶ Using retail price regulation to artificially suppress retail prices only delays an inevitable price increase in the future and can make increases worse than they otherwise might have been.

The availability and take up of time of use tariffs and the impact of time of use tariffs on competition

State and Territory regulators around the country have indicated that as the energy industry transitions to a low-carbon future, setting cost-reflective (as they are required under their terms of reference) regulated retail tariffs is becoming increasingly difficult. These complexities are magnified when tariff structures become increasingly sophisticated as is the case with time of use (flexible) pricing. Once states commit to the deregulation of retail prices the market will set the prices and this will facilitate the transition of customers onto innovative flexible tariffs that will shift consumption to lower cost time periods.

Recently the Productivity Commission found that retail price deregulation is a necessary precondition to the community realising the full benefits of cost reflective pricing.⁷ Price regulation stifles innovation by distorting market efficiency and introducing material risk to retailer operations. Setting inaccurate regulated tariffs, and in particular time of use tariffs, could be detrimental to both energy retailers and consumers. If prices are set too high, consumers could pay too much for energy, although competition from market contracts could mitigate this risk. If prices are set too low, retailers will be unable to recover costs and may exit the market. Furthermore, there are documented dangers of price discounting to households when actual price rises are later applied. As a result of these challenges retailers are always cautious about introducing innovative tariffs in markets where exposure to financial risk is heightened by price

⁴ AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria Second Final Report*, 29 February 2008.

⁵ IPART (2012), *Review of regulated retail prices and charges for electricity 2013 to 2016 Electricity - Issues Paper*.

⁶ IPART (2012), *Review of regulated retail prices and charges for electricity 2013 to 2016 Electricity - Issues Paper*.

⁷ Productivity Commission (2012), *Electricity Network Regulatory Frameworks Draft Report*.

regulation intervention or threat. As noted by the AEMC in its review of the effectiveness of competition in Victoria in 2008 “price regulation in an effectively competitive market is costly in terms of administration, compliance and the distortion it imposes on the effective functioning of the market to the detriment of consumers.”⁸ Where price regulation remains in place so does an unnecessary risk that distorts the market and undermines investor confidence in both retail and generation.

For NSW, it is also important to note that in November 2012 the NSW Smart Meter Task Force Discussion Paper recommended the introduction of a market led approach to smart meters in NSW. Should the recommendation of a market driven roll out be formalised as NSW Government policy, a continuation of price regulation could stifle investment in smart meters as the introduction of time of use tariffs would impact the business case for a roll out. This may have significant adverse consequences for NSW where it is envisaged that the roll out of smart meters and eventually time of use tariffs can assist address the peak issues within the state.

National Energy Customer Framework

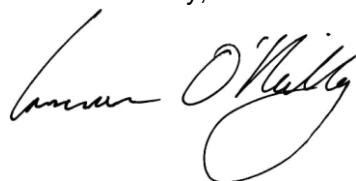
The NSW Government has announced that it will introduce the National Energy Customer Framework (NECF) in NSW on 1 July 2013. Whilst the introduction of NECF is not a precondition for price deregulation in NSW, it is important to note that the NECF was designed as a customer protection framework in a market with deregulated retail prices and provides additional protections to NSW customers that they do not currently have. Under the NECF retailers must publish notice of their standing offer prices one month in advance and provide customers with detailed information on prices, terms and conditions at the point of sale. The ERAA does not believe that the deregulation of energy prices in NSW will reduce customer protections under the NECF.

Transitional arrangements

The ERAA believes that some transitional arrangements are necessary once prices in the NSW retail energy market are deregulated. As was the case following the deregulation of prices in the Victorian market, a consumer awareness and education campaign should be implemented prior to the removal of retail price regulation.

Should you wish to discuss the details of this submission, please contact me on (02) 8241 1800 and I will be happy to facilitate such discussions with my member companies.

Yours sincerely,



Cameron O'Reilly
CEO
Energy Retailers Association of Australia

⁸ AEMC (2008), *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in Victoria Second Final Report*, 29 February 2008.