AEMC 2014 Retail Competition Review: Retailer Interviews

Report for the AEMC

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Glossary

ACT	Australian Capital Territory
AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
B2B	business-to-business
DWGM	Declared Wholesale Gas Market
ESC	Essential Services Commission (Victoria)
ESCOSA	Essential Services Commission of South Australia
ESV	Energy Safety Victoria
FRC	Full Retail Contestability
Gas	Natural gas
ICRC	Independent Competition and Regulatory Commission
IPART	NSW Independent Pricing and Regulatory Tribunal
NECF	National Energy Customer Framework
NEM	National Electricity Market
NERL	National Electricity Retail Law
NSW	New South Wales
NSLP	Net System Load Profile
OTTER	Office of the Tasmanian Economic Regulator
QCA	Queensland Competition Authority
REES	Residential Energy Efficiency Scheme (SA)
RPR	Retail Price Regulation
SA	South Australia
STTM	Short Term Trading Market
VEET	Victorian Energy Efficiency Target

Executive Summary

In early 2014, the Standing Council on Energy and Resources (SCER) provided the Australian Energy Market Commission (AEMC) with the terms of reference for a new annual review of the state of competition in the small customer segment of electricity and natural gas (gas) retail markets across and within the National Electricity Market (NEM) jurisdictions, being the Australian Capital Territory (ACT), New South Wales (NSW), Queensland, South Australia, Tasmania and Victoria.

The AEMC is required under the terms of reference to have regard to the following criteria, where practicable, and subject to data availability and resourcing constraints: [1]

- The ability of suppliers to enter the market;
- Differentiated products and services;
- Independent rivalry within the market;
- The exercise of market choice by customers;
- Customer switching behaviour; and
- Price and profit margins.

To help inform its assessment of these criteria, the AEMC asked K Lowe Consulting (KLC) and Farrier Swier Consulting (FSC) to conduct a survey and a series of one-on-one interviews with retailers, the Energy Retailer's Association of Australia (ERAA) and the Energy Supply Association of Australia (ESAA), to elicit their views on these criteria.

The interviews were conducted between mid-February and mid-March 2014. Of the 23 organisations that were asked to participate in the interview and survey process, 14 agreed to participate in an interview, 13 agreed to complete the electricity survey and seven agreed to complete the gas survey.[2] In total 17 organisations agreed to participate in some form.

An overview of the views expressed by retailers, the ERAA and the ESAA through the interview and survey process is provided below. Before moving on though, it is worth noting that the breadth of issues canvassed through the interview and survey process was quite wide (with questions spanning both gas and electricity retail markets and issues affecting competition in six jurisdictions) and in the limited time available, it was not always possible for participants to provide detailed responses to each issue. This limitation should be borne in mind when reading the report. It is also worth noting that some interviewees' comments relate to jurisdictions in which they do not operate.

State of competition in gas and electricity retail markets

Table E.1 provides a snapshot of the views expressed by interviewees and survey participants about the current state of competition and the outlook for competition in the next five years.

[1] Minister for Industry, Terms of Reference – Australian Energy Market Commission (AEMC) Reporting on the State of Retail Energy Market Competition Across the National Electricity Market, January 2014.

[2] Note that some organisations agreed to participate in both the interview and survey, while others only agreed to participate in the survey or an interview.

Table E.1: Jurisdictional Snapshot – Retailers' Perceptions

<table>
<tr><th></th><th>Electricity Retail Market</th><th>Gas Retail Market</th></tr>
<tr><td colspan="3">ACT</td></tr>
<tr><td>Current State of Competition</td><td>The ACT electricity retail market was viewed by most interviewees and survey participants as having only a limited degree of competition, although one interviewee informed us that customer satisfaction in the ACT is high.</td><td>Like electricity, the ACT retail gas market was viewed by most participants as having only a limited degree of competition.</td></tr>
<tr><td>Factors Influencing Competition</td><td>There are currently two retailers supplying residential customers and three supplying small business customers in this market.
The factors that retailers claim have impeded entry and competition in the ACT electricity retail market include:
▪ Retail Price Regulation (RPR).
▪ ActewAGL's dominance, which has been attributed to a high degree of brand loyalty and the prevalence of bundling in the ACT.
▪ The small size of the market.
▪ Limited customer engagement.</td><td>There are currently only two gas retailers actively supplying this market.
The factors gas retailers claim have impeded entry and competition in this market are:
▪ ActewAGL's dominance in the market.
▪ The small size and peaky nature of demand.
▪ Limited customer engagement.
Tightening conditions in the wholesale gas market and higher wholesale gas prices, brought about by the development of LNG facilities, are also expected to affect entry and competition in this market going forward.</td></tr>
<tr><td>Outlook for the Next 5 Years</td><td colspan="2">Looking forward, retailers appear to have little appetite to enter or actively compete in the ACT retail gas or electricity markets, given the impediments outlined above. Retailers do not therefore expect any material change in the level of competition in either of these markets over the next five years.</td></tr>
<tr><td colspan="3">NSW</td></tr>
<tr><td>Current State of Competition</td><td>The NSW electricity retail market was viewed by most interviewees and survey participants as having a moderate degree of competition. Interviewees did note though that following the privatisation of the government owned retailers there was an intense period of rivalry (driven by AGL's desire to build up its NSW customer base to 800,000), but it has subsequently diminished.</td><td>Most interviewees considered the retail gas market in Sydney to be moderately competitive. It was noted though that the level of competition is lower in some regional areas because of the small size of these markets and/or the regional pipelines are fully contracted.</td></tr>
<tr><td>Factors Influencing Competition</td><td>There are currently 14 electricity retailers active in this market.
The only significant factor that retailers claimed has impeded entry and competition in the NSW electricity retail market is RPR, which is due to be removed on 1 July 2014.</td><td>There are currently five gas retailers active in Sydney.
The factors gas retailers claim have impeded entry and competition in this market are:
▪ RPR.
▪ Access to the Eastern Gas Pipeline (EGP) for small/variable volumes.
▪ The Short Term Trading Market (STTM) and contract carriage model, which some claimed is not as conducive to entry as the Declared Wholesale Gas Market (DWGM) and market carriage model that is in effect in Victoria.
▪ A lower level of gas penetration and average consumption in NSW than Victoria.
Tightening conditions in the wholesale gas market and higher wholesale gas prices, brought about by the development of LNG facilities, are also expected to affect entry and competition in this market going forward.</td></tr>
<tr><td>Outlook for the Next 5 Years</td><td>Looking forward, interviewees expect competition in NSW to improve once RPR is removed, with some noting the potential for NSW to overtake Victoria as customers become more engaged and new entry occurs. The only significant matter retailers told us may affect this outlook is AGL's proposed acquisition of Macquarie Generation, but interviewees were divided on this issue.</td><td>Interviewees do not expect any real improvements in competition to occur in the small customer segment of the NSW retail gas market over the next five years, given the tightening demand and supply conditions in the wholesale gas market. Some have also noted the potential for competition to stagnate in this market.</td></tr>
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<table>
<tr><th></th><th>Electricity Retail Market</th><th>Gas Retail Market</th></tr>
<tr><th colspan="3">Queensland</th></tr>
<tr><td rowspan="2">Current State of Competition</td><td>The SE Queensland market was reportedly relatively competitive prior to the 2012-13 Queensland Government price freeze. However, once the price freeze was imposed, some retailers reportedly stopped actively marketing, prospective entrants deferred plans to enter and there was a significant reduction in competition. While there has been some improvement since, the current state of competition is viewed as ‘benign’.</td><td>Interviewees and survey participants held mixed views about the overall state of competition in this market, with some claiming there is limited competition while others claimed it is relatively or highly competitive.</td></tr>
<tr><td>In regional Queensland, there is currently no competition to supply small electricity customers, with just one retailer operating in this area.</td><td>The level of competition is reportedly lower in regional Queensland because the customer base in some of these areas is too small to attract entry.</td></tr>
<tr><td rowspan="2">Factors Influencing Competition</td><td>There are 10 active electricity retailers in SE Queensland. The factors retailers claim have impeded entry and competition in this market are:
The price freeze, which reportedly led to an increase in the perceived degree of political and regulatory risk and ‘destroyed’ confidence in the market.
RPR and the manner in which it has been applied in Queensland.
Wholesale market volatility.</td><td rowspan="2">There are just two active gas retailers in SE Queensland, Toowoomba and Oakey and one active retailer in the remainder of Queensland. The factors gas retailers claim have impeded entry and competition in this market are:
The ability to access competitively priced gas, which is reportedly becoming ‘extremely difficult’ in Queensland given the demand for gas by the LNG facilities in Gladstone.
The size of the market, which is just 3% of the size of the Victorian market.
The design of the Brisbane STTM and contract carriage model, which they noted is not as conducive to entry as the market carriage model and DWGM applying in Victoria.</td></tr>
<tr><td>According to retailers, the most significant impediment to competition in regional Queensland is the Queensland Government’s Uniform Tariff Policy (UTP), which requires electricity customers in Queensland to have access to the same regulated price (i.e. the SE Queensland regulated price), regardless of their geographic location.</td></tr>
<tr><td rowspan="2">Outlook for the Next 5 Years</td><td>Interviewees are broadly optimistic RPR will be removed and competition will improve once that occurs. However, some cautioned that it could take time before there is a demonstrable increase in competition, because customer engagement has been quite low since the price freeze.
The only factor that interviewees noted could affect competition going forward is the potential privatisation of the government owned generators.</td><td rowspan="2">Little was said by interviewees about the outlook for competition in the Queensland retail gas market, but there is a general expectation that competition will stagnate in those areas that have been reliant on gas supplied from the Cooper or Bowen/Surat basins because a significant proportion of this gas is being dedicated to the LNG facilities.</td></tr>
<tr><td>Interviewees did not expect any changes in the level of competition in regional Queensland until the UTP is removed, or changes are made to the way in which the subsidy is paid.</td></tr>
</table>

	Electricity Retail Market	Gas Retail Market
SA		
Current State of Competition	The SA electricity retail market was viewed as having a relatively high degree of competition, albeit dominated by retailers with SA generation interests because of constraints on the availability of competitively priced SA hedging instruments. The removal of RPR has been viewed as a positive step.	Most interviewees considered the retail gas market in Adelaide to be relatively competitive. It was noted though that the level of competition can be lower in some regional areas because the capacity of some regional pipelines has been fully contracted and/or the customer base is too small to attract entry.
Factors Influencing Competition	There are 14 active electricity retailers in SA. Two of the more significant factors retailers claim have impeded entry and competition in this market are: ▪ Wholesale market conditions and access to competitively priced SA hedging instruments. ▪ The dominance of AGL which some retailers claimed is reinforced by AGL's vertical interests in SA and 'aggressive' retention strategies. ▪ The SA Residential Energy Efficiency Scheme (REES), which has a relatively low threshold and is a non-tradable scheme.	There are five active gas retailers in Adelaide. The factors gas retailers claim have impeded entry and competition in this market are: ▪ Difficulties obtaining access to the SEA Gas Pipeline (which has been fully contracted to 2018) and transporting gas in a westerly direction across the Victorian Transmission System (VTS). ▪ The STTM and contract carriage model, which some claimed is not as conducive to entry as the arrangements in Victoria. Tightening conditions in the wholesale gas market and higher wholesale gas prices, brought about by the development of LNG facilities, are also expected to affect entry and competition in this market going forward.
Outlook for the Next 5 Years	Going forward, most retailers are broadly optimistic that competition will continue to evolve, with some noting the potential for it to overtake Victoria as customers become more engaged and further new entry occurs. However, conditions in the wholesale and hedging markets in SA are expected to continue to weigh on the market, with retailers that have SA generation interests expected to continue to dominate.	Like NSW, interviewees do not expect any real improvements in competition to occur in the small customer segment of the SA retail gas market over the next five years, given the conditions prevailing in the wholesale gas market and the fact that all the existing capacity on the SEA Gas Pipeline is contracted to 2018. Some have also highlighted the potential for competition to stagnate in this market.
Tasmania		
Current State of Competition	There is currently no competition to supply small electricity customers consuming less than 50MW p.a. because full retail contestability (FRC) is only due to be extended to these customers on 1 July 2014.	The level of competition in the Tasmanian retail gas market is perceived by retailers to be limited.
Factors Influencing Competition	Some of the more significant factors interviewees claim may impede entry and competition in this market once FRC is implemented are: ▪ RPR. ▪ The wholesale market arrangements. ▪ The small size and geographic dispersion of the market, the nature of the customer base and limited customer awareness.	There are currently two active retailers in Tasmania. The most significant factors that gas retailers claim have impeded entry and competition in this market are: ▪ The small size of the market and limited scope for growth. ▪ The nature of the residential customer base. ▪ The costs associated with entering into upstream gas and transportation contracting requirements, given the relatively small size of the market. ▪ The viability of the retail market depends on the ongoing viability of industrial gas customers in Tasmania.
Outlook for the Next 5 Years	The outlook for competition in the Tasmanian retail electricity market is unclear at this point in time, because while two small 2nd tier retailers have indicated they may enter, they have also noted the risks associated with entry. Other retailers have stated Tasmania is not currently on their radar.	The outlook for competition in the Tasmanian retail gas market appears poor, with one retailer noting the potential for there to be no retail gas market in Tasmania in the next five years because the market is reportedly 'shrinking, not growing' and its continued viability is highly dependent on industrial loads.

	Electricity Retail Market	Gas Retail Market
Victoria		
Current State of Competition	The Victorian electricity retail market was rated by survey and interview participants as highly competitive.	The level of competition in the locations serviced by the Victorian Declared Wholesale Gas Market (DWGM) was also rated as highly competitive. It was noted though that the level of competition is lower in some regional areas because the capacity of some regional pipelines has been fully contracted and/or the customer base is too small to attract entry.
Factors Influencing Competition	Interviewees attributed the current state of competition in this market to the following factors: ▪ There are currently 16 active electricity retailers in Victoria. ▪ The time elapsed since privatisation, FRC and the removal of RPR. ▪ Wholesale market conditions have been relatively conducive to entry to date. ▪ The high degree of customer engagement.	Interviewees attributed the current state of competition in the DWGM area to the following factors: ▪ There are currently eight active retailers in the DWGM. ▪ The large size of the market (i.e. high penetration of gas and high average consumption). ▪ The Victorian DWGM is relatively conducive to entry by small retailers. ▪ The high degree of customer engagement.
Outlook for the Next 5 Years	Looking forward, retailers expect the Victorian electricity retail market to remain highly competitive. Concerns have been raised by some though about the effect that customer fatigue may have on the market and have speculated SA or NSW could overtake Victoria. Concerns were also raised about the effect that the recent consolidation of generation interests in the Victorian wholesale market and an increase in the perceived degree of political and regulatory risk may have on competition going forward.	Little was said by interviewees about the outlook for the Victorian retail gas market, although some did note that further new entry would prompt a greater degree of rivalry in this market. Some interviewees also noted that while Victoria is in close proximity to large gas reserves, the interconnected nature of the eastern Australian gas market means that retail customers in Victoria will still feel the effect of the tightening demand and supply conditions in the wholesale gas market through higher retail gas prices.

As Table E.1 reveals, there are some marked differences in the state of competition in each market. When asked about these differences, interviewees informed us they primarily reflect:

- How far along the path the jurisdiction is in terms of implementing full retail contestability (FRC), privatising government owned retailers and/or deregulating retail prices, and the approach employed when implementing these changes;
- Whether the jurisdiction represents an attractive proposition for retailers (i.e. will it be profitable to enter), which, amongst other things, will depend on:
  - the size, geographic dispersion and nature of the customer base;
  - the level of customer awareness and engagement;
  - whether retail prices are regulated; and
  - the perceived degree of political and/or regulatory risk.
- The ease with which entry and/or expansion can occur in that jurisdiction.

Entry and expansion conditions

The ease with which entry and expansion occurs in a market can be an important indicator of the extent to which new entrants and small retailers are likely to impose a competitive constraint in that market and, in turn, the effectiveness of competition within a market. To get a better understanding of entry and expansion conditions in gas and electricity retail markets, interviewees and survey participants were asked to:

- rate the ease with which entry and expansion can occur in gas and electricity retail markets in each jurisdiction; and
- identify any significant impediments to entry or expansion within and across jurisdictions.

The ratings retailers assigned in surveys to each market are set out in the table below.

Table E.2: Ease of Entry and Expansion in Retail Electricity Markets – Median Ratings (0 means very difficult and 5 means very easy)

	ACT	NSW	SE Qld	Regional Qld	SA	Tas	Vic
Electricity Retail Markets							
Entry	2.5	3	2	0	4	1	4
Expansion	0.5	2.5	2	0	3	1	3.5
Gas Retail Markets							
Entry	1.5	3	2	0	3	1	4
Expansion	0.5	2.5	2	0	3	1	3

These ratings and interviewees' responses revealed the following insights about entry and expansion conditions:

- Entry and expansion conditions in both gas and electricity retail markets are perceived to be easiest in Victoria, followed in declining order by SA, NSW, SE Queensland, the ACT, Tasmania and regional Queensland (see Table E.2).

- In electricity retail markets, the main impediments to entry and/or expansion are perceived to be:
  - retail price regulation (RPR) in those jurisdictions where it is still applied;
  - access to competitively priced hedging products, which differs across jurisdictions;
  - prudential and credit support requirements; and
  - political and regulatory risk.

  The delayed implementation of NECF in Victoria and Queensland, and differences in consumer protection and environmental schemes across jurisdictions are also reportedly affecting the ease with which electricity retailers can expand across multiple jurisdictions.

  At a rural and regional level, retailers informed us that entry and/or expansion can be impeded by: the small size and geographic dispersion of the customer base; higher customer acquisition costs; and a higher degree of brand loyalty in these areas.
- In gas retail markets, the main impediments to entry and/or expansion are perceived to be:
  - the ‘complex’ and bilateral nature of gas supply arrangements;
  - the small size of some markets;
  - access to some transmission and distribution pipelines; and
  - access to, and/or the price payable for, the wholesale supply of gas.

  The ease with which gas retailers can expand across multiple jurisdictions has, according to some smaller retailers, been impeded by differences in the design of balancing markets and transportation carriage models across jurisdictions.

  In addition to the factors identified by electricity retailers, gas retailers noted that entry and expansion in rural and regions areas can be impeded by the limited coverage of pipeline networks and the fact that some regional pipelines have been fully contracted.

Products differentiation and innovation

To help inform the AEMC’s assessment of the way in which gas and electricity retailers compete, interview and survey participants were asked how gas and electricity retailers try to differentiate their products and the extent to which there has been any product innovation across the NEM jurisdictions.

The responses to these questions revealed the following:

- Gas and electricity retail products currently are sold to residential and small business customers on a single fuel, dual fuel or multi-utility basis and under either a fixed term contract or an evergreen contract. The price and other terms and conditions upon which these products are sold can differ across retailers. So too can the price and non-price inducements retailers use to attract and/or retain customers.

- In relation to product innovation, interviewees noted that there has been limited innovation in electricity retail markets to date and even less innovation in gas retail markets. Interviewees also noted that the roll out of smart meters in Victoria is paving the way for more innovative electricity retail products, but cautioned that innovation may be impeded by regulatory constraints on flexible pricing and data quality issues.

Retailer rivalry

Like entry and expansion conditions, the manner in which retailers compete and the degree of rivalry prevailing in a market can be important indicators of whether a market is effectively competitive. To get some further insight into this issue, interview and survey participants were asked to:

- explain how gas and electricity retailers currently compete; and
- rate the degree of rivalry in gas and electricity retail markets in each jurisdiction.

The responses to these questions indicated the following:

- While gas and electricity retailers employ a variety of techniques to try and distinguish their products, they predominantly compete on the basis of price and in most cases employ the percentage discount method (i.e. percentage discounts are applied to the energy usage rate, the customer's overall bill or the underlying rates).
- As set out in Table E.3 the degree of rivalry in electricity retail markets is perceived to be highest in Victoria, followed in declining order by SA, NSW and SE Queensland, and the ACT. A small number of retailers also noted that the degree of rivalry can be lower in rural and regional areas than it is in urban areas within the same jurisdiction and attributed this to the small size and geographic dispersion of the customer base, higher customer acquisition costs and a higher degree of brand loyalty in these areas.
- In gas retail markets, the degree of rivalry is perceived to be highest in Victoria, followed in declining order by NSW, SA, ACT, Queensland and Tasmania (see Table E.3). The degree of rivalry is also perceived to be lower in rural and regional areas, which retailers attributed to the contractual constraints on some regional pipelines, the size of these markets, higher customer acquisition costs and a higher degree of brand loyalty.
- Larger retailers are starting to place greater emphasis on trying to reduce the cost of churn by employing a variety of price and non-price retention strategies, so a greater degree of competition is now occurring around retention. To the extent the retention strategies result in customers that would otherwise have left remaining with the retailer, switching rates will understate the actual degree of rivalry.

Table E.3: Degree of Rivalry – Median Ratings
(0 means no rivalry and 5 means highly competitive)

	ACT	NSW	SE Qld	Regional Qld	SA	Tas	Vic
Electricity	2	3	3	n.a.	4	n.a.	5
Gas	2	4	2.5		3	1	5

Customer engagement

Customers in an effectively competitive market play an important role in constraining the behaviour of retailers, by switching to another retailer (or another product offered by the same retailer) in response to any deterioration in the price and/or quality of a product. To be able to impose this competitive discipline on retailers, customers must be aware of their ability to switch to another retailer. They must also be able to make informed decisions about the options available to them and be able to readily switch between retailers (or products).

To complement the AEMC's separate assessment of the level of customer engagement, interview and survey participants were asked to provide their perceptions of:

- the level of awareness that small customers have of their ability to switch;
- the degree of switching by small gas and electricity customers in each jurisdiction; and
- the extent to which there are any impediments to customers switching.

The responses to this set of questions revealed the following:

- Retailers believe that the level of awareness amongst gas and electricity customers is highest in Victoria, followed in declining order by SA, NSW, SE Queensland, the ACT, Tasmania and regional Queensland (see Table E.4). The difference across jurisdictions has been attributed by retailers to the different points each jurisdiction is in terms of FRC, privatisation and deregulation.
- In a similar manner to customer awareness, retailers believe that the level of switching by gas and electricity customers is highest in Victoria, followed in declining order by SA, NSW and SE Queensland, the ACT, Tasmania and regional Queensland (see Table E.4). Retailers also noted that there are a number of impediments to switching, including: limited customer awareness and interest; the complexity of retail contracts; misconceptions about the role played by governments and standing contracts; exit fees; and the time taken to transfer.
- Looking forward, improvements in the level of awareness and switching are expected to occur as competition evolves and through media focus on electricity or gas prices. However, retailers noted that educational campaigns may be required in both Queensland and NSW to raise the level of awareness in these jurisdictions as RPR is removed. A targeted education campaign was also suggested for customers on standing offers to inform them of the benefits of switching to a market offer.

Table E.4: Customer Engagement – Median Ratings for Gas and Electricity Customers (0 means non-existent, 3 means moderate and 5 means very high)

	ACT	NSW	SE Qld	Regional Qld	SA	Tas	Vic
Customer Awareness	2	3-4	3	n.a.	4-5	0-2	5
Customer Switching	1	3	3	n.a.	4-4.5	1	5

Prices and profit margins

The prices and profit margins prevailing in a retail market can be important indicators of the effectiveness of competition in that market, because in an effectively competitive market competition should over time drive prices down to the efficient cost of supply, and profit margins down to a level that is commensurate with the risk of supplying the product.

To get a better understanding of how prices are determined and the profitability of retailing, interviewees and survey participants were asked to:

- explain how the prices in market offer contracts are determined in each jurisdiction; and
- rate the profitability of retailing gas and electricity in each jurisdiction.

The responses to these questions can be summarised as follows:

- Where RPR is still in effect, the regulated price acts as the benchmark for market offers, while in other jurisdictions the retailer's own standing offer price acts as the benchmark from which discounts are then offered. These discounts differ depending on the jurisdiction, customer type, product type (e.g. single fuel or dual fuel) and other conditions, but reportedly have ranged from 1% to 30%. In most cases, the discounts are applied to the energy usage component of a customer's bill, but there are some retailers that apply the discount to the customer's overall bill, or directly to the benchmark rates.
- In relation to the profitability of retailing, the survey results (see Table E.5) suggest that:
  - the profitability of electricity retailing is at best moderate, with Victoria viewed as most profitable, followed jointly by SA, NSW and SE Queensland, Tasmania and the ACT; and
  - the profitability of gas retailing is also at best moderate, with Tasmania viewed as most profitable, followed jointly by Victoria, NSW and SA, and then SE Queensland and the ACT.

  Interviewees also informed us that the profit margins earned by retailers can differ depending on the time of year they are measured and can also differ: across retailers (e.g. depending on the retailer's costs); across jurisdictions (e.g. depending on whether RPR applies, the risks of supplying the jurisdiction, jurisdictional specific regulatory and political risks and competition in the jurisdiction); within jurisdictions (e.g. depending on the distribution network in which customers are located); and across customer types (e.g. depending on the volume of energy consumed and the load profile).

Table E.5: Profitability of Retailing – Median Ratings
(0 means not profitable and 5 means very profitable)

	ACT	NSW	SE Qld	Regional Qld	SA	Tas	Vic
Electricity	1	2	2	n.a.	2	1.5	3
Gas	1	2.5	2	n.a.	2.5	3	2.5

1. Introduction

In late 2012, the Council of Australian Governments and the Standing Council on Energy and Resources decided that future reviews of the state of competition in the small customer segment of natural gas (gas) and electricity retail markets, should be conducted annually and encompass all jurisdictions in the NEM[3] (i.e. the ACT, NSW, Queensland, SA, Tasmania and Victoria).

Amendments were made to the Australian Energy Market Agreement in December 2013 to give effect to this revised approach, and in January 2014 the terms of reference for this new annual NEM-wide review were provided to the AEMC.[4] In accordance with these terms of reference the AEMC is required to have regard to the following criteria, where practicable, and subject to data availability and resourcing constraints: [5]

- The ability of suppliers to enter the market;
- Differentiated products and services;
- Independent rivalry within the market;
- The exercise of market choice by customers;
- Customer switching behaviour; and
- Price and profit margins.

In examining these criteria, the AEMC has stated that it will consider the following competitive market indicators:[6]

- the level of customer activity in the market;
- barriers to retailers entering, expanding or exiting the market;
- the degree of independent rivalry, such that retailers are competing strongly with each other to attract and retain customers;
- customer satisfaction with market outcomes; and
- retailer outcomes with respect to prices and competitive retail market costs.

To help inform its assessment of these indicators in the six jurisdictions that comprise the NEM, the AEMC has asked KLC and FSC to:

1. Conduct a series of one-on-one interviews with retailers supplying gas and/or electricity to small customers in the NEM, the ERAA and the ESAA, to obtain a better understanding of retailers' perspectives on the following issues (the 'focus areas'):

[3] SCER, Meeting Communiqué, 14 December 2012, pp. 1-2.

[4] Minister for Industry, Terms of Reference – Australian Energy Market Commission (AEMC) Reporting on the State of Retail Energy Market Competition Across the National Electricity Market, January 2014.

[5] Minister for Industry, Terms of Reference – Australian Energy Market Commission (AEMC) Reporting on the State of Retail Energy Market Competition Across the National Electricity Market, January 2014.

[6] AEMC, 2014 Retail Competition Review - Approach Paper, 17 January 2014, p9.

(a) The ease with which a retailer can enter, expand and exit gas and electricity retail markets within and across each jurisdiction.

(b) The importance of economies of scale,[7] economies of scope[8] and vertical integration in gas and electricity retail markets.

(c) The manner in which gas and electricity retailers compete (e.g. price rivalry[9] vs non-price rivalry)[10] and the overall degree of rivalry within and across each jurisdiction.

(d) The types of products offered by gas and electricity retailers, the degree of product differentiation and innovation across jurisdictions and the marketing and retention strategies employed by retailers.

(e) The level of customer engagement in each jurisdiction.

(f) Prices and profit margins in gas and electricity retail markets in each jurisdiction.

(g) The outlook for competition in gas and electricity retail markets over the next five years and the factors potentially influencing competition over this period.

(h) The state of competition in those markets that have not previously been subject to a competition review and are still employing retail price regulation (RPR), i.e. the South East Queensland and Tasmanian retail electricity markets.

2. Prepare a report setting out how the interviews were conducted and the views expressed by retailers on each of the focus areas.

1.1 Retailer interviews

In early February 2014, we contacted the ERAA, the ESAA and retailers supplying small gas and/or electricity customers and asked if they were interested in participating in a one-on-one interview and/or completing a separate survey.[11]

Of the 23 organisations contacted, 14 agreed to participate in a one-on-one interview and 13 agreed to complete the survey. The interviews were conducted between 14 February and 11 March 2014, with four carried out by phone and the remainder conducted in person in either Sydney or Melbourne. In total 17 organisations agreed to participate in the process in one form or another.

Appendix A sets out the questions posed in the interviews and surveys. In short, the questions were designed to elicit information on retailers' experiences in gas and electricity retail markets across the NEM and their views on each of the focus areas.

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7 The term 'economies of scale' is used in this context to refer to a situation where retailer's long run average cost declines as the size of its customer base increases. This may occur if a retailer has significant fixed or sunk costs.

8 The term 'economies of scope' refers to a situation where the unit cost of supplying two or more products or services (e.g. gas and electricity) is lower for a given level of output than if those products or services were supplied by two separate retailers.

9 Price rivalry can take a number of forms including discounts, rebates and alternative tariff structures.

10 Non-price rivalry can take a number of forms including service, incentives, bundling products and non-price contract terms.

11 The list of entities contacted was discussed and agreed with the AEMC.

To encourage candid responses to these questions, it was agreed that all responses to the interviews and surveys would be treated confidentially. It was also agreed that any report published at the completion of the interviews would aggregate responses in such a manner that it would not be possible to attribute a particular response to an individual retailer.

1.2 Report structure

The remainder of this report sets out the views expressed by retailers, the ERAA and ESAA on each of the focus areas and is structured as follows:

- Chapter 2 provides an overview of the interview and survey process, the questions posed, and the participating retailers.
- Chapter 3 contains a snapshot of retailers' views on entry and expansion conditions, retailer rivalry, product differentiation, customer engagement and the state of competition in gas and electricity retail markets in the six jurisdictions that comprise the NEM.
- Chapter 4 sets out retailers' views on the ease with which entry, expansion and exit can occur in gas and electricity retail markets and the importance of economies of scale, economies of scope and vertical integration.
- Chapter 5 focuses on retailer product offerings, product differentiation and innovation, and the marketing and retention strategies employed by retailers.
- Chapter 6 outlines retailers' perceptions on the degree of retailer rivalry that currently exists in gas and electricity retail markets and how retailers compete.
- Chapter 7 sets out retailers' views on the level of customer engagement in gas and electricity retail markets.
- Chapter 8 outlines the feedback retailers provided on how gas and electricity retail prices are determined and the profit margins available in each jurisdiction.
- Chapter 9 provides an overview of the factors that retailers expect to have greatest influence on competition in gas and electricity retail markets over the next five years.

1.2.1 Limitations

The one-on-one interviews were relatively long and the breadth of issues canvassed in each interview was quite wide, with questions spanning both gas and electricity retail markets, and issues affecting competition in six jurisdictions. This breadth constrained the ability of interview participants to respond in detail on all issues; and the issues selected by different respondents for more detailed commentary varied considerably. This limitation should be borne in mind when reading this report.

Readers should also be mindful that this report captures views expressed by retailers, the ERAA and the ESAA. Where necessary to aid understanding, KLC and FSC have tried to clarify and validate interview and survey responses. However, such efforts do not constitute comprehensive validation and testing, nor is this report an independent critique by KLC and FSC of retailers' views.

1.3 Acknowledgments

Compiling a report such as this is dependent on the time, effort and cooperation of respondents. We would like therefore to take this opportunity to thank the retailers that agreed to participate, the ERAA and the ESAA for setting aside time to participate in this process, and for providing their valuable insights into the range of issues currently affecting retail competition in gas and electricity markets within and across the NEM.

2. Interview and Survey Process and Participants

To provide some context to the discussion that follows in the remainder of this report, this chapter provides an overview of:

- the interview and survey process;
- the questions that were posed in the interviews and survey;
- the sample of retailers that agreed to participate in the interview and survey process; and
- the terminology that we have used to distinguish between the different types of retailers.

2.1 Interview and survey process

In early February 2014 we contacted all of the retailers identified in Table 2.1,[12] the ERAA and the ESAA and asked them if they would be interested in participating in a one-on-one interview and/or completing a separate survey. Of the 23 organisations contacted:

- ten agreed to participate in both a one-on-one interview and the survey;
- four agreed to participate in the one-on-one interview only; and
- three agreed just to complete the survey.

In total, 14 one-on-one interviews were conducted between 14 February and 11 March 2014. Four of these were carried out by phone and the remainder were carried out in person in Sydney or Melbourne with representatives from KLC, FSC and, in some cases, the AEMC. The length of each interview varied, depending on the jurisdictional coverage of the retailer's operations and whether the retailer supplied both gas and electricity, or just electricity, but in general they took 1.5-2.5 hours to complete.

In relation to the survey, a separate set of survey questions were developed for both gas and electricity. Of the 13 organisations that agreed to participate in the survey, 13 completed the electricity survey and seven completed the gas survey.

2.2 Questions posed in the interviews and surveys

The interview questions, which were developed in consultation with the AEMC, were designed to get a better understanding of retailers' experiences in gas and electricity retail markets across the NEM and to elicit their views on the focus areas set out in the introduction. The types of questions retailers were asked about each of these issues are set out in Table 2.2.

[12] The list was agreed with the AEMC. The only retailer supplying small customers in the NEM that was active at the time we conducted the interviews that we did not contact was Ergon Retail. However, we understand that it has spoken directly to the AEMC. Ergon Retail is currently the only retailer supplying small electricity customers in northern and western Queensland (i.e. outside SE Qld).

Table 2.1: Retailers Asked to Participate in Interview/Survey Process

Organisation	Types of Small Customers Supplied		Jurisdictions in which the Retailer is Actively Supplying Residential or Small Business Customers (* used to identify those jurisdictions where a retailer is not supplying some rural or regional areas)													Vertical Interests	
			Electricity						Gas								
											Queensland						
	Residential	Small Business	ACT	NSW	SE Qld	SA	Tas	Vic	ACT	NSW	SE Qld	Regional Qld^	SA	Tas	Vic	Electricity Generation in the NEM	Upstream gas interests in Eastern Aus.
ActewAGL	✓	✓	Host	*SE Region*					Host	*SE Region*							
AGL (Also trading as Powerdirect and AP&G)	✓	✓		*		Host		Host		Host *	Host	Host *	*		Host *		
Alinta (Also trading as Neighbourhood Energy)	✓	✓											*		*		
Aurora	✓	✓					Host										
Blue NRG	×	✓															
Click Energy	✓	✓															
Diamond Energy	Primarily Residential																
Dodo Power and Gas	✓	✓													*		
EnergyAustralia	✓	✓		Host				Host	*	*			*		Host		
ERM	×	✓															
Go Energy	✓	✓															
Lumo Energy	✓	✓								*					*		
Momentum	✓	✓															
Origin Energy	✓	✓		Host	Host			Host		Host *	Host	Host	Host		Host *		
People Energy	✓	✓															
Powershop	✓	✓															
QEnergy	Primarily Small Business			*													
Red Energy	✓	✓													*		
Sanctuary Energy	✓	×															
Simply Energy	✓	✓											*		*		
Tas Gas Retail	✓	✓															

Sources: Reponses to survey and interview questions, retailer websites and AER, State of the Energy Market, 2013, p121.

Notes: The term 'host retailers' is defined by the AER as follows:

- Host retailers in NSW, ACT and Tasmania are 'those responsible for offering 'regulated offer' contracts to customers in defined regions of each state'.
- Host retailers in Victoria, SA and Queensland are 'those responsible for offering 'standing offer' contracts to customers that establish a new connection in defined regions of each state'.

^ The bounds of this market have been determined having regard to the bounds of Energex' distribution network. In short, this market includes Envestra's Hervey Bay, Maryborough, Bundaberg, Gladstone and Rockhampton distribution networks and that part of Allgas Energy's distribution network that extends into Toowoomba and Oakey.

Table 2.2: Types of Interview Questions

Focus Area	Types of questions
Nature of the retailer's operations	Retailers were asked to identify: ▪ the jurisdictions in which they hold a licence to retail gas or electricity to small customers and the jurisdictions they are actively[13] retailing; and ▪ any interests they have in electricity generation or upstream gas exploration/production.
Ability to enter, expand and exit each market	Those retailers that had entered, expanded or exited a market in the last five years were asked to provide an overview of their experience. Interview participants were also asked to provide their opinion on whether: ▪ there are any significant impediments to entry, expansion or exit within or across each jurisdiction; ▪ differences in licensing requirements, regulations and environmental schemes are making it difficult for retailers to enter and/or expand across multiple jurisdictions; and ▪ the National Energy Customer Framework (NECF) has reduced any of these impediments.
Importance of economies of scale, scope and vertical integration	Interview participants were asked how important economies of scale, economies of scope (e.g. offering dual fuel or multi-utility products) and vertical integration are in each jurisdiction.
Products offerings	Interview participants were asked to explain: ▪ how retailers distinguish their products from other retailers; ▪ the extent to which customer preferences influence product offerings; ▪ the degree of product differentiation and innovation across jurisdictions; and ▪ the importance of dual fuel or multi-utility product offerings across jurisdictions.
Marketing and retention strategies	Interview participants were asked to outline the key marketing and retention strategies retailers employ, the customers that are targeted and the effectiveness of these strategies.
Retailer rivalry	Interview participants were asked to: ▪ explain the basis on which retailers currently compete; ▪ identify the factors that are likely to affect rivalry in a jurisdiction; and ▪ rate the degree of rivalry across jurisdictions and note whether there had been any change in rivalry over the last two years.
Prices and profit margins	Interview participants were asked to: ▪ describe what benchmarks retailers use when setting prices under market contracts; ▪ explain how discounts are applied and whether customers understand the discounting structures adopted by retailers; and ▪ explain why profit margins can differ either within or across jurisdictions. Retailers were also asked to respond to a set of questions about the retail component (i.e. retail operating costs *plus* retail margin) in Victoria and why it may be higher than in other jurisdictions.[14]
Customer engagement	Interview participants were asked to provide their opinion on: ▪ the level of awareness that customers have of their ability to switch in each jurisdiction; ▪ what prompts customers to switch and if there are any impediments to switching; and ▪ the degree of customer switching in each jurisdiction.
Overall level of competition	Interview participants were asked to rate the overall level of competition in each jurisdiction and to provide their opinion on what distinguishes those jurisdictions that are relatively competitive from those that are less competitive.
Future developments	Interview participants were asked whether they thought there would be any change in the structure, conduct or performance of retail markets over the next five years and whether there were any specific issues that may affect competition over this period.

13 The term 'actively retailing' is used in this report to refer to retailers that hold a retail licence or retailer authorisation to supply customers in a particular jurisdiction and that are currently supplying customers in that jurisdiction.

14 This area of questioning arose out of the finding in the AEMC's 2013 Residential Electricity Price Trends report that the retail cost component appeared to be higher in Victoria in 2013 than it was in NSW, SA and SE Queensland. See AEMC, 2013 Residential Electricity Price Trends, 13 December 2013, pxiv.

A survey was also developed to enable a more standardised assessment of some of the focus areas across the six jurisdictions that comprise the NEM. The survey asked retailers to provide factual information on their retail operations and their strategy for each jurisdiction over the next five years (i.e. entry, expansion, exit or unchanged). Survey participants were also asked to rate the matters set out Table 2.3 across all of the jurisdictions they currently operate, have operated in, or are considering entering:[15,16]

Table 2.3: Survey Questions

Survey question	Rating scale
How would you rate the ease with which **entry, expansion** and **exit** can occur in each jurisdiction on a scale of 0 to 5?	0 means very difficult and 5 means very easy
How would you rate the degree of **price**, **non-price** and **overall rivalry** in each jurisdiction on a scale of 0 to 5?	0 means no rivalry and 5 means highly competitive
How would you rate the degree of **product differentiation** and **innovatio**n in each jurisdiction on a scale of 0 to 5?	0 means no differentiation or innovation and 5 means a high degree of differentiation and innovative
How would you rate the **profitability** in each jurisdiction of retailing on a scale of 0 to 5?	0 means not profitable and 5 means very profitable
How would you rate the level of **customer awareness** and **switching** in each jurisdiction on a scale of 0 to 5?	0 means non-existent and 5 means very high
How would you rate the **overall level of competition** in each jurisdiction on a scale of 0 to 5?	0 means no competition and 5 means effectively competitive.

Questions were also posed in the survey about whether retailers perceive there to be any difference between the degree of rivalry in urban versus rural and regional areas, or any additional barriers to retailing in rural or regional areas.

To ensure appropriate coverage of both gas and electricity retail markets, separate sets of interview and survey questions were developed for retailers operating in these markets. A modified set of interview and survey questions was also developed for the ERAA and the ESAA. A copy of the questions that were asked during the interviews and survey can be found in Appendix A.[17]

15 The ratings used in each of these survey questions are explained in the survey (see Appendix A).

16 While survey participants were asked to limit their answers to the jurisdictions that they currently operate, have previously operated in, or are considering operating in, a number of participants provided responses for other jurisdictions. In many of these cases the responses did not provide a fair reflection of the conditions prevailing in the jurisdiction. For example, one retailer that doesn’t operate in Tasmania assigned a rating of four to the degree of price rivalry in this state (i.e. competitive) and assigned the same rating to Victoria.

To limit the potential for the survey results to be distorted by these types of responses, we have excluded any jurisdictional responses, where the retailer is not currently operating in that jurisdiction, has not previously operated in that jurisdiction and has not indicated it is considering operating in that jurisdiction. The only exception to this general rule is that we have considered all of the jurisdictional responses provided by the associations.

17 Interview time constraints precluded asking all of the questions set out in Appendix A in each interview.

2.3 Retailers participating in the interviews and surveys

Table 2.1 identifies the retailers that were asked to participate in a one-on-one interview and/or complete the survey. Of the 21 retailers contacted, 15 agreed to participate in the interview and survey process.

To encourage candour, we undertook to treat all specific interview and survey responses confidentially; though it was agreed that aggregated information and non-attributed quotes would be published. We cannot therefore identify the 15 participating retailers. However, we can state that the sample of retailers that agreed to participate in the interview and survey process consisted of:

- 15 retailers that are currently supplying electricity to small customers in the ACT, NSW, SE Queensland, SA, Tasmania and/or Victoria. Of these 15 retailers, 12 agreed to participate in an interview while a different[18] group of 12 agreed to participate in the survey.
- Eight retailers that are currently supplying gas to small customers in the ACT, NSW, Queensland, SA, Tasmania and/or Victoria. or are in the process of entering these markets. All of these retailers agreed to participate in the interview, but only six agreed to participate in the survey.

While fewer gas retailers participated in the interviews, when expressed as a percentage of the total number of gas retailers in Table 2.1 (72%), the representation of gas retailers is broadly the same as it is for electricity retailers (75%).

Some other general characteristics of the sample of participating electricity and gas retailers are set out in Table 2.4. When compared with the information in Table 2.1, it is apparent that the characteristics of the sample of gas and electricity retailers are broadly consistent with those exhibited by the wider population of retailers. When coupled with the relatively high participation rates (72% for gas and 74% for electricity), the composition of the sample may be viewed as being broadly representative of the population of gas and electricity retailers supplying small customers in the NEM jurisdictions.

[18] Note that some retailers decided to just participate in an interview while others agreed to just participate in the survey and some agreed to participate in both.

Table 2.4: Characteristics of the Sample of Electricity and Gas Retailers

Characteristics	Electricity retailers (15 retailers or 75% of active retailers)	Gas retailers (8 retailers or 72% of active retailers)
NEM coverage	The sample of retailers accounted for 66-100% of the electricity retailers in each jurisdiction.	The sample of retailers accounted for 50-100% of the gas retailers in each jurisdiction.
Rural/regional coverage	The majority of electricity retailers in the sample are offering to supply rural/regional areas.	Only a small sub-set of the sample of gas retailers is offering to supply rural and regional areas. This is consistent with the broader population of gas retailers (see Table 2.1) and appears to reflect, amongst other things, the size of these markets and contractual constraints on some regional pipelines.
No. of jurisdictions retailers operate in	With one or two exceptions, all the retailers in the sample are operating across two or more jurisdictions.	
Host vs 2nd tier retailers	The sample of electricity retailers consists of a representative mix of host and 2nd tier retailers	The sample of gas retailers consists of a representative mix of host and 2nd tier retailers.
New entrants	Three of the electricity retailers have commenced operations in the last two years and another five have entered new jurisdictions in this period.	Two of the gas retailers have commenced retailing gas in the last two years.
Types of small customers supplied	14 of the electricity retailers are supplying residential customers and 13 are supplying small business customers.	All the gas retailers in this sample are supplying residential and small business customers.
Vertical interests	Just less than half the sample of electricity retailers has an interest in generation in the NEM.	Less than half the sample of gas retailers has interests in upstream gas production and/or exploration.
Supplying electricity and/or gas	Eight of the electricity retailers in the sample are retailing gas and another two are in the process of entering the Victorian retail gas market.	All of the gas retailers are also retailing electricity and all but one are marketing gas as a dual fuel product.

2.4 Terminology

To distinguish between the different types of retailers operating across the NEM, we have used the following terminology for the purposes of this report:

- The term ‘host retailer’ is used to refer to retailers that are obligated to:
  - offer a regulated offer contract in those jurisdictions where RPR is still applied; and
  - offer to supply gas or electricity to all customers in the local area in those jurisdictions where RPR is no longer applied.

  The list of electricity host retailers includes ActewAGL, AGL, Aurora, EnergyAustralia, Ergon and Origin Energy, while the list of gas host retailers includes ActewAGL, AGL and Origin Energy and EnergyAustralia (see Table 2.1).

- The term ‘the big three’ is used to refer to AGL, Origin Energy and EnergyAustralia.
- The term ‘second tier’ is used to refer to retailers such as Lumo, Simply Energy, Red Energy, Alinta, Blue NRG, Click Energy, Diamond Energy, Dodo Power and Gas, Go Energy, Momentum, Tas Gas Retail, Powershop, People Energy and Sanctuary Energy.

3. Jurisdictional Snapshot

Drawing on interview and survey responses, this chapter provides a high level overview of the views expressed by interview and survey participants about:

- why the state of competition differs in each jurisdiction;
- the current state of competition in the ACT, NSW, Queensland, SA, Tasmanian and Victorian electricity and gas retail markets; and
- the outlook for competition in each of these markets over the next five years, which retailers informed us could be influenced by the range of exogenous factors set out in Table 3.1.

Table 3.1: Exogenous Influences on Retail Market Competition

Market	Exogenous Influences
Electricity retail markets	Whether RPR is removed in any of the jurisdictions it is still applied. Conditions in the wholesale and hedging markets. Further privatisation of government owned generation assets. Declining demand for electricity in some areas. Competition from off-grid sources and new types of players.
Gas retail markets	Tighter demand and supply conditions in the wholesale gas market, which has been triggered by the development of LNG facilities in Queensland and is expected to affect: ▪ retailers' access to and/or the price payable for, the wholesale supply of gas; and ▪ the wholesale supply options available to retailers.

A more detailed discussion of these issues can be found in Chapters 4-9.

3.1 Why the state of competition differs across jurisdictions

Although full retail contestability (FRC) for small gas and electricity customers has been in place in most jurisdictions for 7-12 years,[19] the state of competition in gas and electricity retail markets varies markedly across the jurisdictions. To get a better understanding of why there is such a difference, we asked retailers for their views on what has led to the differences. An overview of their responses is provided below.

3.1.1 Differences in the state of competition in electricity retail markets

When asked why the state of competition differs in electricity retail markets across the NEM, interviewees informed us that the difference primarily reflects:

- How far along the path the jurisdiction is in terms of implementing FRC, privatising government owned retailers and/or deregulating retail prices and the approach employed when implementing these changes;

[19] The one exception to this is Tasmania, which is due to extend FRC to customers consuming less than 50 MWh p.a. of electricity from 1 July 2014.

- Whether the jurisdiction represents an attractive proposition for retailers (i.e. will it be profitable to enter), which, amongst other things, will depend on:
  - the size, geographic dispersion and nature of the customer base;
  - the level of customer awareness and engagement;
  - whether retail prices are regulated; and
  - the perceived degree of political and/or regulatory risk.
- The ease with which entry and/or expansion can occur, which according to retailers will depend primarily upon:
  - whether the jurisdiction still regulates retail prices and, if so, the manner in which prices are regulated by the jurisdictional regulator;
  - wholesale market conditions and the extent to which retailers can enter into competitively priced hedging arrangements to cover their wholesale position; and
  - whether there are any other regulatory or legislative barriers in that jurisdiction.

3.1.2 Differences in the state of competition in gas retail markets

When asked the equivalent question for gas, interviewees informed us that differences in the state of competition in gas retail markets across the NEM primarily reflects:

- Whether the jurisdiction represents an attractive proposition for retailers (i.e. will it be profitable to enter), which, amongst other things, will depend on:
  - the size and nature of the demand for gas by residential and small business customers, which will depend on the penetration and average consumption of gas, and the relative competitiveness of gas versus electricity prices in that jurisdiction;
  - the geographic dispersion and nature of the customer base;
  - the level of customer awareness and engagement;
  - whether retail prices are regulated; and
  - the perceived degree of political and/or regulatory risk.
- The ease with which entry and expansion can occur, which can differ across jurisdictions depending on:
  - the wholesale gas supply and transportation options available to the retailer;
  - the transportation carriage model that has been adopted in that jurisdiction (i.e. market carriage in the Declared Wholesale Gas Market (DWGM) or contract carriage elsewhere);
  - the design of any imbalance market implemented in that jurisdiction (i.e. the DWGM in Victoria or the Short Term Trading Market (STTM) in Adelaide, Brisbane and Sydney); and
  - whether there any regulatory or legislative barriers to entry in that jurisdiction.

3.1.3 Differences between electricity and gas retail markets

Interviewees also informed us that the state of competition can differ in gas and electricity markets within the same jurisdiction, for the following reasons:

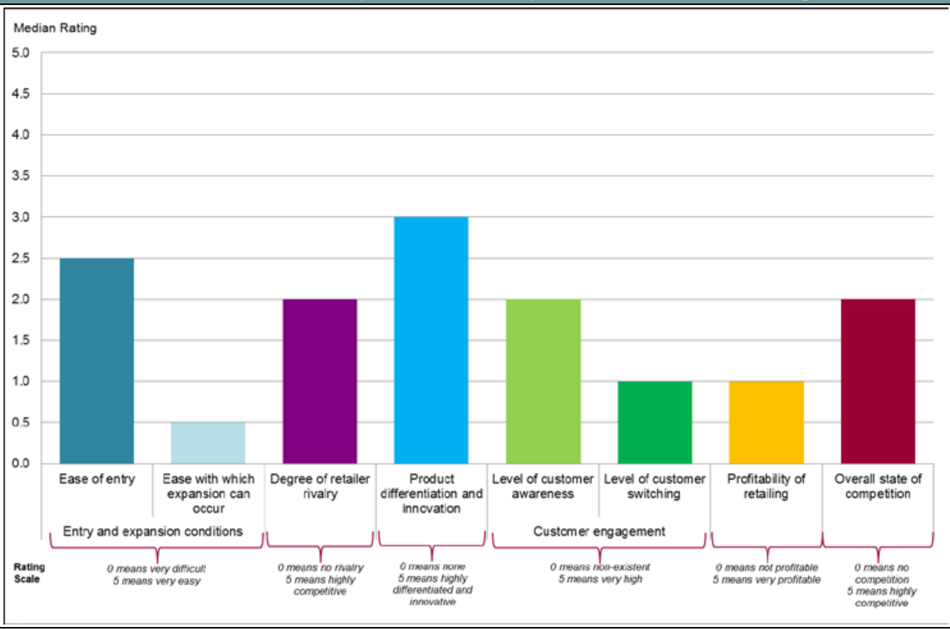
- From a retailer's perspective, retailing gas constitutes a very different proposition to retailing electricity (i.e. because the wholesale supply and transportation arrangements in gas are fundamentally different from the arrangements in electricity).
- From a customer's perspective, gas tends to be a lower involvement product than electricity, and switching decisions by gas customers tend to be linked to their electricity switching decisions.
- Gas is not as prevalent as electricity, so the number of gas and electricity retailers in a jurisdiction is likely to differ.

3.2 ACT retail electricity and gas markets

Table 3.2 and Table 3.3 provide a snapshot of retailers' views on the state of competition in retail electricity and gas markets in the ACT.

Table 3.2: ACT Retail Electricity Market

Structural and Regulatory Features of the ACT Retail Electricity Market	
Number of active retailers	2 retailers supplying residential customers and 3 supplying small businesses. The host retailer, ActewAGL, is jointly owned by the ACT Government and AGL.
NECF in place?	Yes, since 1 July 2012.
RPR in place?	Yes – applied by the Independent Competition and Regulatory Commission (ICRC).
ACT Retail Electricity Market Survey Results - Median Ratings	

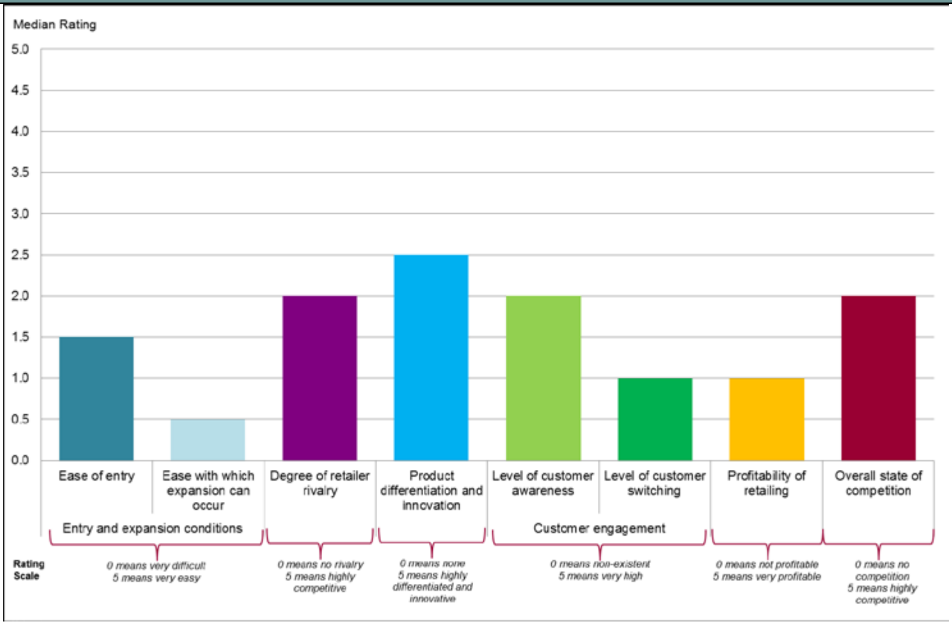


<table>
<tr><th colspan="3">Views on the Current State of Competition in the ACT Retail Electricity Market</th></tr>
<tr><td rowspan="2">Ease of entry and expansion</td><td>Rating</td><td>Survey and interview participants rated entry into the ACT retail electricity market as difficult and expansion as even more difficult.</td></tr>
<tr><td>Impediments to entry and/or expansion</td><td>Some of the more significant factors that interviewees claimed can impede entry and/or expansion in the ACT retail electricity market include:
▪ RPR and the manner in which it is applied by the ICRC (i.e. no allowance provided for customer acquisition and retention costs and retail operating costs are based on ActewAGL's costs rather than a new entrant's). According to interviewees, this approach provides retailers with little or no incentive to enter or actively compete.
▪ The dominance of the host retailer, ActewAGL, which most interviewees noted is reinforced by the degree of brand loyalty exhibited by customers in the ACT, the prevalence of bundling and the manner in which RPR is applied.
▪ The small size of the market and the peaky nature of demand.
Interviewees also noted that economies of scale can be important in the ACT.</td></tr>
<tr><td rowspan="2">Degree of rivalry</td><td>Rating</td><td>Survey and interview participants rated the degree of rivalry in this market as 'limited'.</td></tr>
<tr><td>Changes in rivalry over the last two years</td><td>All but one of the interviewees we spoke to about the ACT believe there has been no change in rivalry in the last two years. The one interviewee that stated there has been a change claimed that rivalry has improved through things like the One Big Switch.</td></tr>
<tr><td colspan="2">Differentiation and innovation</td><td>Product differentiation and innovation in the ACT market is considered to be relatively high compared to most jurisdictions. Interviewees attributed this to ActewAGL's approach to bundling (e.g. offering electricity, gas, phone and/or internet services).</td></tr>
<tr><td colspan="2">Level of customer awareness</td><td>While one of the interviewees we spoke to about the ACT claimed that the level of awareness is high, the remainder believe it is limited.
One interviewee cautioned that brand loyalty should not be confused with limited customer awareness, because loyalty can be an indicator of customer satisfaction. To illustrate this point, the interviewee referred to independent surveys that have confirmed there is a high degree of customer satisfaction in the ACT.</td></tr>
<tr><td colspan="2">Level of switching</td><td>Participants observed a limited degree of customer switching between retailers, but the One Big Switch campaign reportedly resulted in an increase in switching between products offered by the same retailer.</td></tr>
<tr><td colspan="2">Profitability of retailing</td><td>Electricity retailing in the ACT was rated as relatively low because of the manner in which the ICRC applies RPR.</td></tr>
<tr><td colspan="2">Overall state of competition</td><td>Viewed by retailers as having only a limited degree of competition. Two interviewees also made the following observations about the state of competition in the ACT:
'Competition [in the ACT] has deteriorated since the last AEMC review.'
'The ACT is dead from a competition perspective.'
According to interviewees, impediments to competition in the ACT include: RPR and the manner in which it is applied by the ICRC; ActewAGL's dominance in the market; brand loyalty; and the relatively small size of the market. Some interviewees also interpreted statements contained in the ICRC's recent standing offer draft decision as suggesting it has 'given up on competition' in the ACT.
While the overall state of competition in the ACT is viewed by retailers as limited, customers in the ACT are reportedly satisfied.</td></tr>
<tr><th colspan="3">Outlook for Competition in the ACT Retail Electricity Market</th></tr>
<tr><td colspan="2">Potential entry or expansion in next 5 years</td><td>Survey responses suggest that one small retailer may consider entry into the small business segment, while another may consider entry into the residential segment. However, neither retailer currently has firm plans to enter at this stage.
An existing retailer stated it has no plans to expand because it 'has bigger fish to fry'.</td></tr>
<tr><td colspan="2">Outlook for competition over the next 5 years</td><td>Looking forward, retailers do not expect any material change in the level of competition in this market over the next five years.</td></tr>
</table>

Table 3.3: ACT Retail Gas Market

Structural and Regulatory Features of the ACT Retail Gas Market	
Gas consumption[20]	Gas penetration rate: 74.6% Average household usage: 46.3 GJ[21]
Number of active retailers	2 retailers
NECF in place?	Yes, since 1 July 2012
RPR in place?	No
Transport & Balancing Models	Contract carriage transportation model. No formal balancing market.

ACT Retail Gas Market Survey Results - Median Ratings



Views on the Current State of Competition in the ACT Retail Gas Market

The ACT retail gas market was viewed by most interviewees and survey participants as having only a limited degree of competition for the following reasons:

- There are currently only two retailers supplying the market.
- The market is difficult to enter and harder to expand within. Three of the more significant factors that interviewees claim are impeding entry and/or expansion include:
  - The relatively small size of the market and peaky nature of gas demand, which interviewees informed us can pose a risk for new entrants that are unable to diversify this risk.
  - ActewAGL's dominance in this market, which was attributed by some interviewees to the high degree of brand loyalty and the prevalence of bundling in the ACT.
  - Access to, and/or the price of, gas, given the LNG developments in Queensland and tightening demand and supply conditions in the wholesale gas market.
- The level of customer awareness is considered to be quite low (note that in a similar manner to electricity, conflicting views were expressed about this) and the level of switching even lower.

Outlook for Competition in the ACT	
Potential entry or expansion in next 5 years	None of the retailers surveyed or interviewed indicated that they plan to enter or expand in the ACT market over the next five years.
Outlook for competition over the next 5 years	In a similar manner to the retail electricity market, retailers appear to have little appetite to enter or actively compete in the ACT retail gas market, given the impediments outlined above. Retailers do not therefore expect any material change in the level of competition in this market over the next five years.

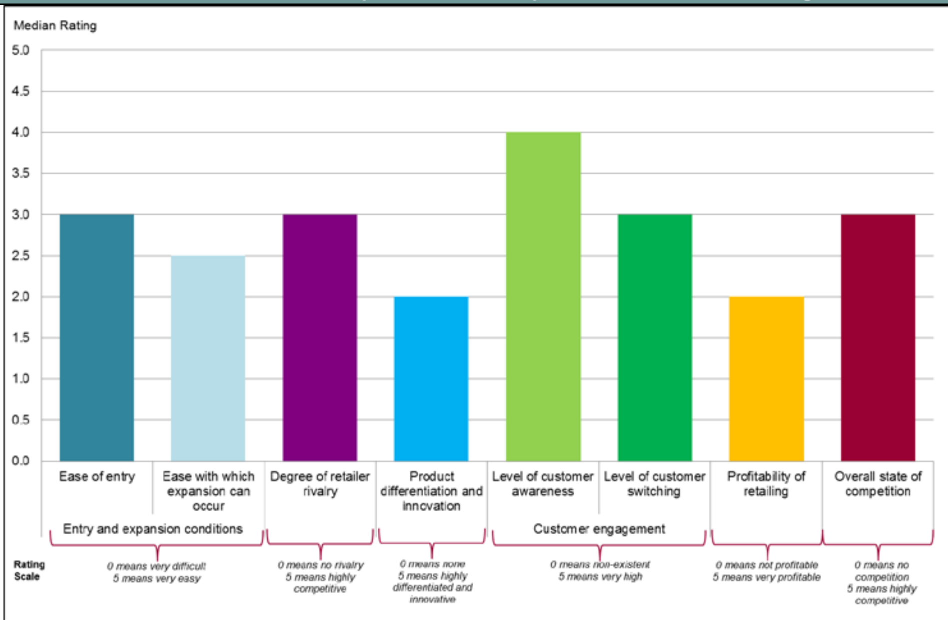
20 Bureau of Resources and Energy Economics (BREE), 2013 Energy Consumption by Industry and Fuel Type, Table F (2011-12) and ABS, 4602.0.55.001 Environmental Issues: Energy Use and Conservation, March 2011, Table 6.

21 NIEIR, Natural gas projections for ActewAGL Distribution, p30.

3.3 NSW retail electricity and gas markets

Table 3.4 and Table 3.5 provide a snapshot of retailers' views on the state of competition in retail electricity and gas markets in NSW.

Table 3.4: NSW Retail Electricity Market

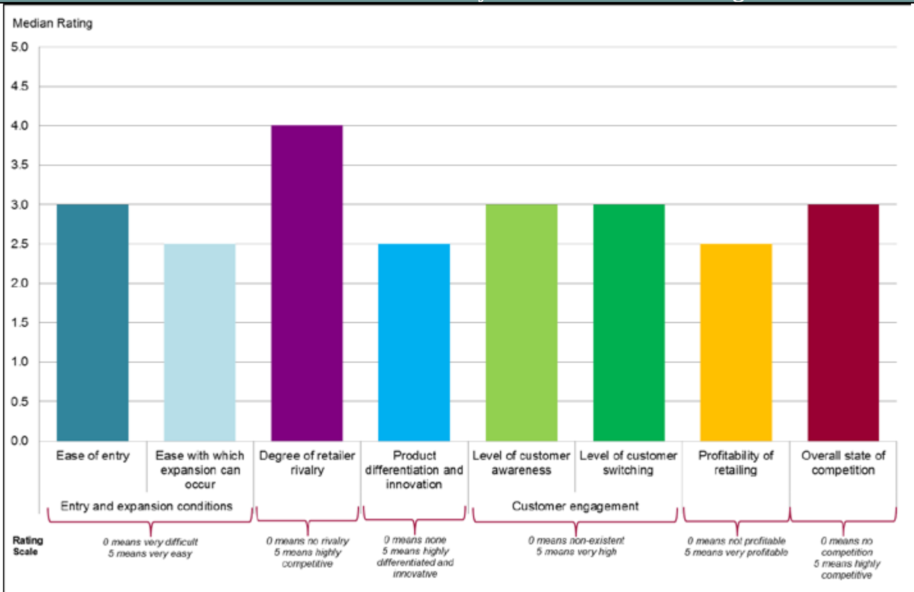
<table>
<tr><th colspan="3">Structural and Regulatory Features of the NSW Retail Electricity Market</th></tr>
<tr><td colspan="2">Number of active retailers</td><td>14 retailers</td></tr>
<tr><td colspan="2">NECF in place?</td><td>Yes, since 1 July 2013</td></tr>
<tr><td colspan="2">RPR in place?</td><td>At the time of the interviews RPR was in effect but on 7 April 2014 the NSW Government announced it would be removed with effect from 1 July 2014.
Note that the interviews and surveys were conducted before the NSW Government decision to remove RPR. To the extent that knowledge of this outcome may have affected ratings and/or the views expressed by participants, this should be borne in mind when evaluating these ratings and/or views.</td></tr>
<tr><th colspan="3">NSW Retail Electricity Market Survey Results - Median Ratings</th></tr>
<tr><td colspan="3">
</td></tr>
<tr><th colspan="3">Views on the Current State of Competition in the NSW Retail Electricity Market</th></tr>
<tr><td rowspan="2">Ease of entry and expansion</td><td>Rating</td><td>Survey and interview participants rated entry into the NSW market as reasonably easy and expansion as neither easy nor difficult.</td></tr>
<tr><td>Impediments to entry and/or expansion</td><td>Some of the more significant factors that interviewees claimed may impede entry and/or expansion in the NSW retail electricity market include:
▪ RPR – while most retailers informed us that recent Independent Pricing and Regulatory Tribunal (IPART) decisions had provided sufficient headroom for competition to emerge, they also told us that the mere presence of RPR constitutes a risk and can act to deter new entry and rivalry.
▪ Access to hedging products from the NSW Government owned generators, although interviewees noted they have been able to rely on interregional hedges, financial intermediaries and/or the futures market.
▪ A degree of brand loyalty to EnergyAustralia and Origin, with some customers purportedly confused about their ability to choose a different retailer if they are located in the old EnergyAustralia, Integral or Country Energy networks.</td></tr>
</table>

<table>
<tr><td rowspan="2">Degree of rivalry</td><td>Rating</td><td>Rated as having a moderate degree of rivalry.</td></tr>
<tr><td>Changes in rivalry over the last two years</td><td>Rivalry was reportedly ‘intense’ in NSW following the privatisation of the state owned retailers, but has subsequently diminished.
The increase was attributed to AGL’s decision to build up its NSW customer base to 800,000 customers, which occurred in late 2013 when it acquired Australian Power and Gas (AP&G). One retailer described the rivalry during this period as involving a ‘vicious fight for market share’. According to this retailer, competition primarily occurred amongst the big three, and the deep discounting had not been profitable.</td></tr>
<tr><td colspan="2">Differentiation and innovation</td><td>Rated as having a limited degree of product differentiation and innovation. Interviewees attributed this relatively low rating to RPR and the small number of smart meters in the state.</td></tr>
<tr><td colspan="2">Level of customer awareness</td><td>Participants held conflicting views about customer awareness in NSW, with some claiming customers are ‘not particularly’ aware, while others claim there is a ‘reasonable’ level of awareness and that customers are becoming more engaged.
One concern raised by a number of interviewees about customer awareness in NSW is that customers may not understand that their choice of retailer is not related to the distribution network they are located in. This group suggested that further work be done to educate NSW customers about the choices they have.</td></tr>
<tr><td colspan="2">Level of switching</td><td>Participants observed a moderate degree of switching, but some noted that switching activity in NSW could overtake Victoria as customers in this state become more engaged.</td></tr>
<tr><td colspan="2">Profitability of retailing</td><td>Electricity retailing was rated by survey participants as somewhat profitable. Interviewees also informed us that retailing in NSW is less profitable than Victoria and attributed this to the application of RPR and the deep discounting that has occurred over the last two years.</td></tr>
<tr><td colspan="2">Overall state of competition</td><td>Rated as having a moderate degree of competition. RPR was the only factor interviewees claimed has impeded competition in NSW over the last two years.</td></tr>
<tr><th colspan="3">Outlook for Competition in the NSW Retail Electricity Market</th></tr>
<tr><td colspan="2">Potential entry or expansion in next 5 years</td><td>Interviewees viewed NSW as an attractive market in terms of size, regulatory and political stability, with further entry considered likely once RPR is removed.
Survey responses indicate that one small retailer is in the process of entering the NSW market, another small retailer is considering entry and four existing 2nd tier retailers are planning to expand over the next five years.</td></tr>
<tr><td colspan="2">Outlook for competition over the next 5 years</td><td>Interviewees expect competition in NSW to improve once RPR is removed, with some noting the potential for NSW to overtake Victoria as customers become more engaged and further new entry occurs.
The only significant matter that retailers informed us may affect this outlook is AGL’s proposed acquisition of Macquarie Generation. However, it is worth noting that the interviewees we spoke to were divided on this issue, with some saying it won’t affect entry conditions in the future because retailers can use interregional hedges, while others claim it would act as an impediment by reducing liquidity in the hedging market in NSW. The diversity of views on this issue can be seen in the following contrasting quotes from two small interviewees:
‘If AGL doesn’t acquire Macquarie Generation, AGL will eventually reach a maximum number of customers that it can service without having generation and this could adversely affect competition, because Origin and EnergyAustralia will be the only retailers able to compete at the larger scale, which, in effect, would result in a duopoly in the state. Such an outcome could be worse for customers’.
‘If AGL acquires Macquarie Generation there will be scraps and crumbs for smaller players, but not enough access to hedging instruments to underpin a fourth big player.’</td></tr>
</table>

Table 3.5: NSW Retail Gas Market

Structural and Regulatory Features of the NSW Retail Gas Market	
Gas consumption[22]	Penetration rate: 48% in Sydney, 25% in regional areas. Total residential demand 2011-12: 25 PJ Average household usage: 23.5 GJ p.a.
Number of active retailers	5 retailers in Sydney
NECF in place?	Yes, since 1 July 2013
RPR in place?	Yes - *Note the NSW Government's decision to remove RPR in electricity does **not** apply to gas.*
Transport & Balancing Models	Contract carriage transportation model. Short Term Trading Market (STTM) in Sydney.

NSW Retail Gas Market Survey Results - Median Ratings



Views on the Current State of Competition in Sydney

Most interviewees considered the retail gas market in Sydney to be moderately competitive for the following reasons:

- There are five retailers supplying the market (one of which is a 2nd tier retailer).
- While the market can be more difficult to enter than Victoria, there has been new entry in the last two years (i.e. Lumo and AP&G). Some of the factors identified by interviewees as impeding entry and/or expansion in this market include:
  - Access to, and/or the price of, gas, given the LNG developments in Queensland and tightening demand and supply conditions in the wholesale gas market.
  - RPR.
  - The STTM and contract carriage model, which interviewees claim is not as conducive to entry for smaller retailers as the DWGM and market carriage model in Victoria.
  - Access to the EGP and/or the costs associated with obtaining transportation capacity for small and variable volumes.
  - Gas penetration and average consumption is far lower in NSW than Vic (48% and 24 GJ p.a. vs 91% and 58 GJ p.a.).
- There is a 'reasonable' level of customer awareness and there has been a moderate degree of switching by customers.

Views on the Current State of Competition in Rural and Regional Areas of NSW

A number of interviewees informed us that the level of competition can be lower in some regional areas of NSW because: the capacity of some regional pipelines has been fully contracted; and/or the customer base is too small to attract entry.

Outlook for Competition in the NSW Retail Gas Market	
Entry or expansion in next 5 years	Survey responses suggest one retailer is considering entry, an existing retailer is planning to expand and another existing retailer is in the process of expanding into regional areas.
Outlook for competition over the next 5 years	In the next five years, interviewees do not expect any real improvements in competition to occur in the small customer segment of the NSW retail gas market, given the tightening demand and supply conditions in the wholesale gas market. As one retailer noted: *'We expect LNG to disrupt and distort the market for a while and it is possible the retail market may stagnate, with new entrants deciding just to wait and see what happens until things settle down.'* According to some, the tightening wholesale market conditions will be felt most acutely in NSW, with retail gas prices expected to rise by around 20%. Some retailers also noted the potential for supply shortfalls to occur in peak periods from as early as 2016, but stated this was unlikely to affect small customers.

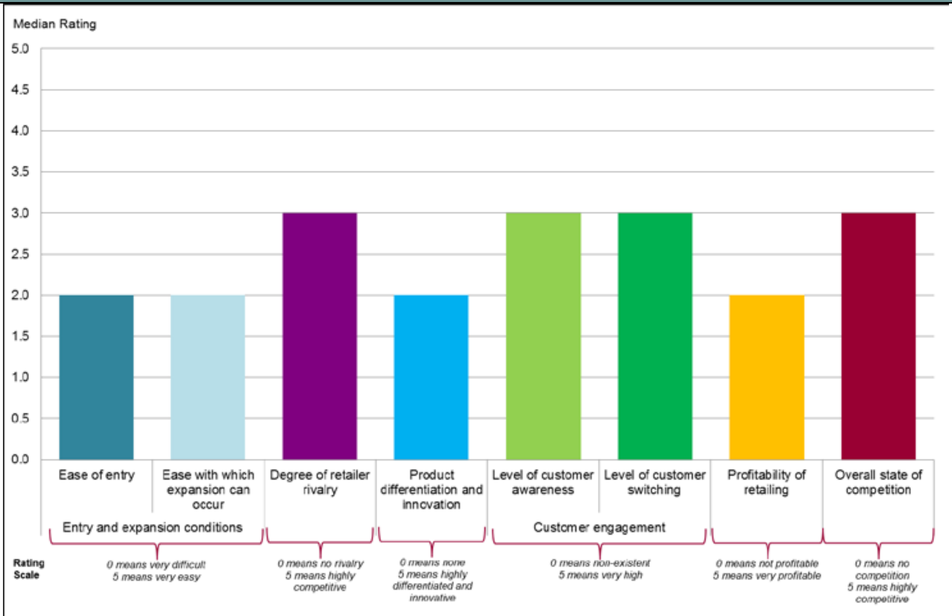
[22] See footnote 20.

3.4 Queensland retail electricity and gas markets

Table 3.6 and Table 3.7 provide a snapshot of retailers' views on the state of competition in SE Queensland and regional Queensland retail electricity markets, while Table 3.8 sets out retailers' views on the state of competition in retail gas markets.

Table 3.6: SE Queensland Retail Electricity Market

<table>
<tr><th colspan="3">Structural and Regulatory Features of the SE Queensland Retail Electricity Market</th></tr>
<tr><td colspan="2">Number of active retailers</td><td>10 retailers.</td></tr>
<tr><td colspan="2">NECF in place?</td><td>No.</td></tr>
<tr><td colspan="2">RPR in place?</td><td>Yes – applied by the Queensland Competition Authority (QCA).
On 17 June 2013, the Queensland Government announced that it would remove RPR in SE Queensland by 1 July 2015 and move toward price monitoring, subject to sufficient customer protections being in place.</td></tr>
<tr><th colspan="3">SE Queensland Retail Electricity Market Survey Results - Median Ratings</th></tr>
<tr><td colspan="3">



</td></tr>
<tr><th colspan="3">Views on the Current State of Competition in the SE Queensland Retail Electricity Market</th></tr>
<tr><td rowspan="2">Ease of entry and expansion</td><td>Rating</td><td>Survey and interview participants rated SE Queensland as being a relatively difficult market to enter and expand.</td></tr>
<tr><td>Impediments to entry and/or expansion</td><td>Some of the more significant factors that interviewees claimed may impede entry and/or expansion in the SE Queensland retail electricity market include:
The Queensland Government's 2012-13 price freeze. Apart from affecting entry and expansion at the time it was in effect, the price freeze and intervention by the Queensland Government more generally, has reportedly led to an increase in the perceived degree of political and regulatory risk and 'destroyed' retailers' confidence in the market and adversely affected the attractiveness of the market.
RPR and the manner in which it has been applied by the QCA since 2012 (i.e. the treatment of wholesale costs, the Clean Energy Regulator's forecasting errors and the fact that it applies as a cap). Interviewees noted though that the QCA's 2014-15 draft determination represents a positive step and entry conditions are expected to improve.
Wholesale market volatility. According to one retailer, the Queensland wholesale market is becoming more akin to SA in terms of volatility and interconnector constraints.
The degree of brand loyalty exhibited by some customers, which according to one interviewee has resulted in 2nd tiers 'really struggling in SE Queensland'.</td></tr>
</table>

<table>
<tr><td rowspan="2">Degree of rivalry</td><td>Rating</td><td>Rated as moderate but interviewees claim rivalry has been ‘benign’ since the price freeze.</td></tr>
<tr><td>Changes in rivalry over the last two years</td><td>According to interviewees, the SE Queensland market was relatively competitive prior to the 2012-13 Queensland Government price freeze, with a relatively large number of active retailers and a reasonable level of switching. However, once the price freeze was imposed, some retailers reportedly stopped actively marketing, prospective new entrants deferred plans to enter and there was a significant reduction in rivalry.

While the price freeze ended on 30 June 2013, interviewees claim that the QCA’s 2013-14 decision was ‘biased on the low side’, so there has been no significant change in rivalry since the price freeze was lifted. As one retailer explained:

‘In our view there is not sufficient headroom in South East Queensland to be actively retailing at present.’

The QCA’s recent 2014-15 draft determination has been viewed more favourably by interviewees, so there is an expectation that competition will start to improve.

Retailers’ views on rivalry in SE Queensland over the last two years are reflected in the following statement made by a larger retailer:

‘There is a relationship between margins and competition. So with the implementation of the price freeze competition definitely did take a bit of a dive. We are starting to see changes now with the QCA’s recent draft determination. So competition is starting to increase relative to what it was in the year before.’</td></tr>
<tr><td colspan="2">Differentiation and innovation</td><td>Rated as having a limited degree of product differentiation and innovation. Interviewees attributed this to RPR and the small number of smart meters in SE Queensland.</td></tr>
<tr><td colspan="2">Level of customer awareness</td><td>Participants held conflicting views about the level of customer awareness in SE Queensland, with some claiming the price freeze and consequent reduction in marketing have adversely affected customer awareness. Other interviewees, on the other hand, claimed that while these factors have affected the level of switching, they have not affected customers’ awareness of their ability to switch.</td></tr>
<tr><td colspan="2">Level of switching</td><td>Interviewees noted that switching rates fell substantially during the 2012-13 price freeze and have not been restored to these levels, because retailers have put little effort into actively marketing in this jurisdiction.</td></tr>
<tr><td colspan="2">Profitability of retailing</td><td>Electricity retailing in SE Queensland was rated as somewhat profitable by survey participants, although it was noted by a large number of interviewees that the price freeze and subsequent regulatory decision by the QCA had:
▪ adversely affected the profitability of retailing in SE Queensland, with one interviewee informing us that the price freeze resulted in ‘20% of the gross margin being removed in some areas’; and
▪ ‘forced’ one Queensland based retailer to move into other jurisdictions to remain commercially viable.</td></tr>
<tr><td colspan="2">Overall state of competition</td><td>The current state of competition in the SE Queensland retail electricity market is viewed by retailers as ‘benign’ but improving.</td></tr>
<tr><td colspan="3">Outlook for Competition in the SE Queensland Retail Electricity Market</td></tr>
<tr><td colspan="2">Potential entry or expansion in next 5 years</td><td>Survey responses suggest that two small retailers are considering entry while four existing 2nd tier retailers are planning to expand over the next five years.

Interviewees also informed us that there are at least two other 2nd tier retailers currently supplying commercial and industrial customers in Queensland that could readily move into the small customer segment if entry conditions improve.

When asked about the likely timing of these activities, interviewees stated that no new entry or expansion was likely to occur until RPR was actually removed.</td></tr>
</table>

Outlook for competition over the next 5 years	Interviewees seemed broadly optimistic that the Queensland Government would follow through on its proposal to remove RPR by mid-2015. However, some cautioned that even once RPR is removed it could take time before there is a demonstrable increase in competition, because the level of customer engagement is quite low and work is required to improve awareness, particularly following the price freeze. To this end, a number of interviewees suggested that the Queensland Government conduct an educational campaign if it decides to remove RPR. When asked whether Queensland was likely to adopt NECF, retailers stated that while they expected it to occur they also anticipated a significant number of jurisdictional derogations. The only other factor that interviewees noted could affect competition going forward is the potential privatisation of the Queensland Government owned generators. Elaborating further on this point, one interviewee stated: *'The Queensland wholesale market is becoming more like the SA market, so if the Queensland Government wants to avoid replicating the problems seen in the SA market, then it will need to carefully consider how it sells the assets, who it sells the assets to and how non-vertically integrated retailers will be able to access competitively priced hedging instruments.'*

Table 3.7: Regional Queensland Retail Electricity Market

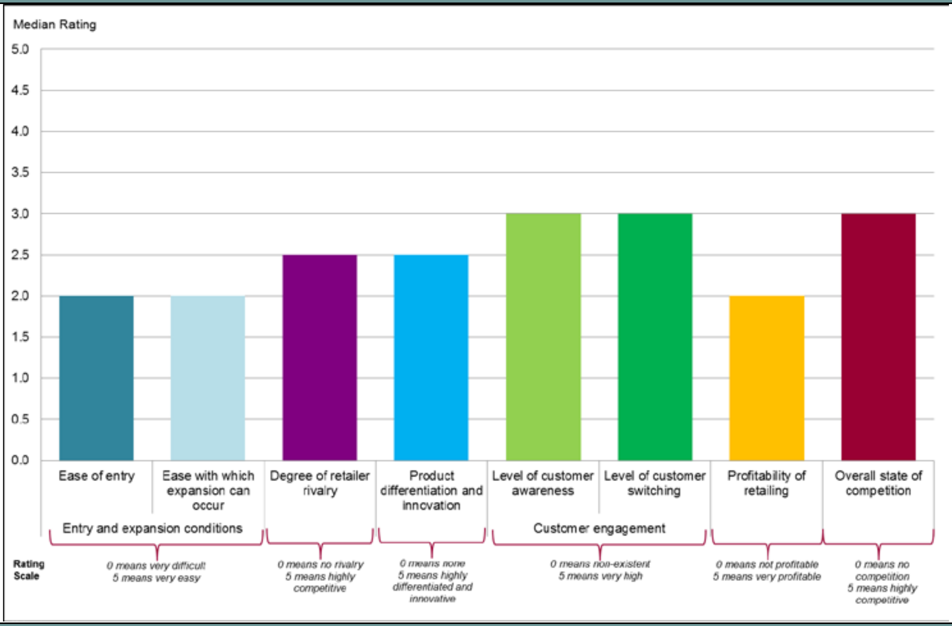
Structural and Regulatory Features of the Regional Queensland Retail Electricity Market	
Number of active retailers	Ergon Energy (owned by Queensland Government and operates distribution networks in regional Queensland) is the only retailer currently supplying small customers in this region.
NECF in place?	No
RPR?	The Uniform Tariff Policy (UTP) applies in regional Queensland. In short, this policy requires electricity customers in Queensland to have access to the same regulated price (i.e. the SE Queensland regulated price), regardless of their geographic location. To give effect to this policy, a subsidy is paid by the Queensland Government to Ergon Retail (in its retailer capacity) and Origin Energy in prescribed areas.
Views on the Current State of Competition in the Regional Queensland Retail Electricity Market	
Current state of competition	During the interviews we were informed that one small retailer had been operating in regional Queensland, but following a change in the QCA's approach to setting regulated prices in SE Queensland it was no longer profitable to supply these areas. According to retailers, the most significant impediment to competition emerging in regional Queensland is the UTP, because: ▪ retailers are unable to supply electricity at the same price that they are able to do so in SE Queensland (i.e. because transmission and distribution costs are higher); and ▪ unlike Ergon Retail, they are not entitled to any of the subsidy the Queensland Government pays to maintain the UTP.
Outlook for Competition in the Regional Queensland Retail Electricity Market	
Outlook for competition over the next 5 years	Interviewees did not expect any changes in the level of competition in regional Queensland until the UTP is removed, or changes are made to the way in which the subsidy is paid (i.e. the subsidy is paid to the distribution network rather than the final retailer). The UTP is perceived to be the biggest hurdle and the only factor that retailers focused on. However, given the parallels that exist between regional Queensland and Tasmania (i.e. small and geographically dispersed markets) and, to a lesser extent, the ACT, it is possible that some of the factors retailers identified as limiting competition in these markets (e.g. brand loyalty, high customer acquisition costs and low levels of customer awareness) *may* also be relevant in regional Queensland.

Table 3.8: SE Queensland and Regional Queensland Retail Gas Markets

Structural and Regulatory Features of the Queensland Retail Gas Market

Gas consumption[23]	Gas penetration rate: 18.6% in Brisbane and 5% in regional areas. Total residential demand in 2011-12: 2.9 PJ Average household usage: 15 GJ p.a.
Number of active retailers	SE Queensland: 2 retailers Regional Queensland: 2 retailers in Toowoomba and Oakey. 1 retailer in Gladstone, Rockhampton, Wide Bay, Bundaberg, Maryborough and Hervey Bay.
NECF in place?	No
RPR in place?	No
Transport & Balancing Models	Contract carriage transportation model. STTM in Brisbane.

SE Queensland Retail Gas Market Survey Results - Median Ratings



Views on the Current State of Competition in SE Queensland

The interviewees we spoke to about the SE Queensland market held mixed views about the overall state of competition in this market, with some claiming there is limited competition while others claimed it is relatively or highly competitive.

The interviewees that claimed there is *limited* competition pointed to the following factors in support of their claim:

- There are currently only two retailers competing in this market.
- There are a number of significant impediments to entry in this market, including:
  - Access to, and/or the price of, gas, which they noted was becoming 'extremely difficult' in Queensland given the proximity of this market to the LNG developments and because some LNG proponents were yet to secure all of their gas requirements.
  - The size of the market, which they noted is just 3% of the size of the Victorian market.
  - The STTM and contract carriage model, which interviewees claim is not as conducive to entry for smaller retailers as the DWGM and market carriage model in Victoria.

Those interviewees that claimed it was either *relatively competitive or highly competitive*, noted that:

- The behaviour of retailers in this market is constrained by the electricity retail market because gas is a 'fuel of choice'.
- Entry by a 2nd tier retailer (AP&G) has occurred in the past.

Views on the Current State of Competition in Regional Queensland

The level of competition is reportedly lower in regional Queensland because the customer base is too small to attract entry.

Outlook for Competition in the Queensland Retail Gas Market

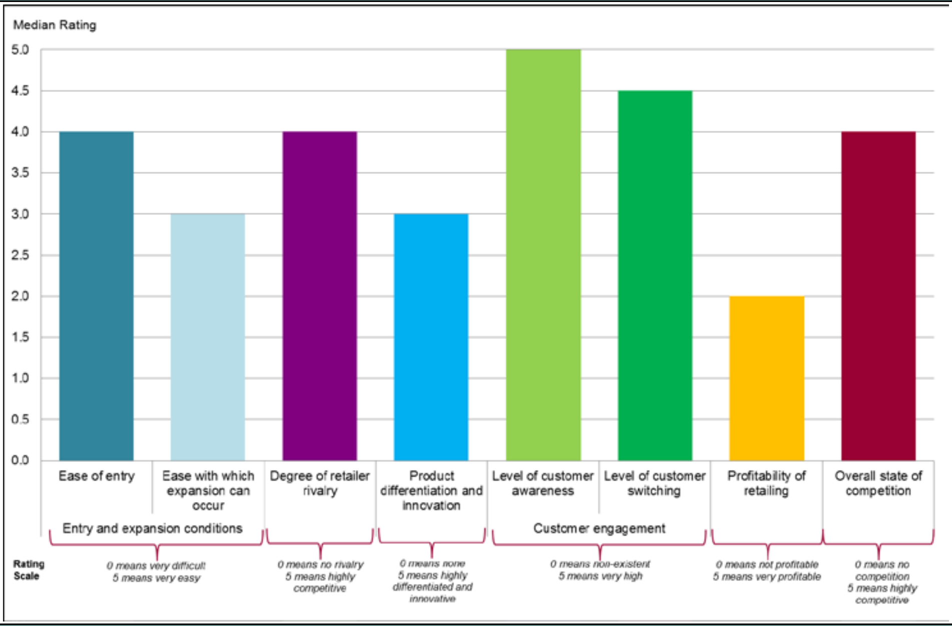
Entry or expansion in next 5 years	Survey responses indicate that one retailer is 'considering' entry into the SE Queensland and regional Queensland retail gas markets in the next five years, but it has no firm plans to do so at this stage.
Outlook for competition over the next 5 years	Little was said by interviewees about the outlook for competition in the Queensland retail gas market, but there is a general expectation that competition will stagnate in those areas that have been reliant on gas supplied from the Cooper or Bowen/Surat basins because a significant proportion of this gas is being dedicated to the LNG facilities.

23 See footnote 20.

3.5 SA retail electricity and gas markets

Table 3.9 and Table 3.10 provide a snapshot of retailers' views on the state of competition in retail electricity and gas markets in SA.

Table 3.9: SA Retail Electricity Market

<table>
<tr><th colspan="3">Structural and Regulatory Features of the SA Retail Electricity Market</th></tr>
<tr><td colspan="2">Number of active retailers</td><td>13[24] retailers, five of which have generation interests in SA</td></tr>
<tr><td colspan="2">NECF in place?</td><td>Yes, since 1 February 2013</td></tr>
<tr><td colspan="2">RPR in place?</td><td>RPR removed on 1 February 2013. Price monitoring currently in place.
As part of the deregulation process, AGL entered into a voluntary price arrangement with the SA Government. Under this agreement, AGL agreed to reduce the standing offer by 9.1% and maintain it at that level for two years, subject to changes in network charges and environmental scheme costs.</td></tr>
<tr><th colspan="3">SA Retail Electricity Market Survey Results - Median Ratings</th></tr>
<tr><td colspan="3">
</td></tr>
<tr><th colspan="3">Views on the Current State of Competition in the SA Retail Electricity Market</th></tr>
<tr><td rowspan="3">Ease of entry and expansion</td><td>Rating</td><td>Survey ratings suggest that SA is a relatively easy market to enter. However, concerns were raised by non-vertically integrated retailers about the difficulties associated with accessing hedging instruments in SA at a competitive price.</td></tr>
<tr><td>Impediments to entry and/or expansion</td><td>Some of the more significant factors that interviewees claimed may impede entry and/or expansion in the SA retail electricity market include:
▪ Access to and/or the price of SA hedging instruments.
▪ The dominance of the host retailer, AGL, which some interviewees claim is reinforced by AGL's vertical interests in SA and 'aggressive' retention strategies.
▪ Potentially the voluntary pricing arrangement AGL has in place with the SA Government; because it effectively places a cap on the price other retailers can charge under their market offers.
▪ The SA Residential Energy Efficiency Scheme (REES), which has a relatively low threshold (i.e. a retailer's obligation under this scheme commences as soon as it has 5,000 customers) and is a non-tradable scheme.</td></tr>
<tr><td>Recent entry</td><td>Some new entry has occurred in SA over the last two years, although we were informed that one new entrant has already wound back its activities because of hedging issues and 'aggressive' retention strategies employed by the host retailer.</td></tr>
</table>

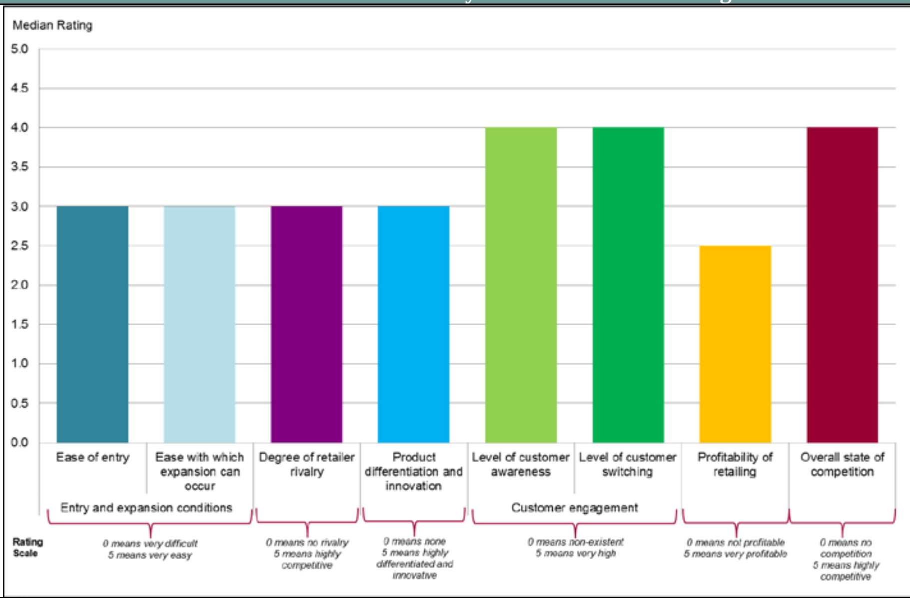
24 This count excludes Pacific Hydro, which entered the market in May 2014.

Degree of rivalry	**Rating**	Rated as having a relatively high degree of retailer rivalry.
	Changes in rivalry over the last two years	As the following comments indicate, the removal of RPR in February 2013 does not appear to have resulted in a significant increase in rivalry in SA: *‘While the removal of RPR may have prompted one or two new entrants, the market was already quite competitive. The removal of RPR did not see the flurry of activity that might be expected in a less competitive market.’* *‘South Australia has been a bit of a slow burn and deregulation came out of the blue, so rivalry has taken time to ramp up.’* One other retailer noted that while there have been some ‘competitive blips’ in SA there has been no sustained increase in rivalry.
Differentiation and innovation		Rated as having a moderate degree of product differentiation and innovation.
Level of customer awareness		Survey participants rated customer awareness as very high, but three interviewees claimed that SA customers are ‘not particularly aware’ of their ability to switch.
Level of switching		Interview and survey participants rated the level of switching in SA as relatively high.
Profitability of retailing		Electricity retailing in SA was rated as somewhat profitable by survey participants. Interviewees informed us that while RPR has been removed, retailing in SA is less profitable than Victoria because AGL’s voluntary pricing arrangement is ‘artificially’ constraining prices. One smaller retailer also informed us that SA profit margins are ‘all over the place’ and can change frequently depending on the retailer’s wholesale position.
Overall state of competition		Rated by survey participants as having a relatively high degree of competition, albeit dominated by retailers with SA generation interests. The removal of RPR has been viewed by retailers as a positive step for competition in SA. However, concerns remain about the effect of constraints on the availability of hedging products in SA on the ability of retailers *without* generation interests in SA to effectively compete in the retail market, with one relatively new entrant having already reportedly wound back its activities for this reason.
Outlook for Competition in the SA Retail Electricity Market		
Potential entry or expansion in next 5 years		Survey responses suggest that three smaller 2nd tier retailers are considering entry into this market over the next five years, while four existing retailers are planning to expand over this period. One of the 2nd tier retailers that has generation interests in SA noted that entry into NSW would be easier if RPR is removed than it is in SA, because: *‘…while RPR is no longer in effect in SA, the costs of operating in this state can be quite high given the risks in this market. For example, if the interconnectors go down retailers are more exposed to SA regional prices, so retailers may need a larger risk buffer on the energy component of their costs.’*
Outlook for competition over the next 5 years		Going forward, most retailers are broadly optimistic that competition will continue to evolve in SA, with some noting the potential for it to overtake Victoria as the most competitive market in Australia, as customers become more engaged and further new entry occurs. However, conditions in the wholesale and hedging markets in SA are expected to continue to weigh on the market and, as a consequence, retailers with generation interests in SA are expected to continue to dominate in this market.

Table 3.10: SA Retail Gas Market

Structural and Regulatory Features of the SA Retail Gas Market	
Gas consumption[25]	Gas penetration rate: 75% in Adelaide and 14% in regional areas Total residential demand in 2011-12: 11.7 PJ Average household usage: 30 GJ p.a.
Number of active retailers	5 retailers in Adelaide.
NECF in place?	Yes, since 1 February 2013.
RPR in place?	No removed on 1 February 2013. Like AGL, Origin entered into a voluntary price arrangement with the SA Government. Under this agreement, Origin agreed to reduce the standing offer by 1%.
Transport & Balancing Models	Contract carriage transportation model. STTM in Adelaide.

SA Retail Gas Market Survey Results - Median Ratings



Views on the Current State of Competition in Adelaide

Interviewees considered the degree of competition in Adelaide to be relatively high for the following reasons:

- There are five retailers supplying the market (two of which are 2nd tier retailers).
- While the market can be more difficult to enter than Victoria, there has been new entry in the last two years (i.e. Alinta). Three of the more significant factors identified by interviewees as impeding entry and/or expansion in Adelaide are:
  - Access to, and/or the price of, gas, given the LNG developments in Queensland and tightening demand and supply conditions in the wholesale gas market.
  - Difficulties obtaining access to the SEA Gas Pipeline (which has been contracted by Origin, GDF Suez, AGL and EnergyAustralia to 2018) and transporting gas in a westerly direction across the VTS. While some interviewees noted there may be capacity on the Moomba to Adelaide Pipeline System (MAPS), they informed us it would be 'very difficult to purchase gas from producers in the Cooper and Bowen/Surat basins given demand from LNG is pulling gas north'.
  - The design of the STTM and contract carriage model, which some interviewees claimed is not as conducive to entry as the DWGM and market carriage model in Victoria.
- The level of customer awareness and switching are both considered to be relatively high in SA.

Views on the Current State of Competition in Rural and Regional Areas

A number of interviewees informed us that the level of competition is lower in some rural and regional areas of SA (e.g. Mt Gambier and Murray Bridge) than it is in Adelaide because the capacity of some regional pipelines has been fully contracted and/or the customer base in these locations is too small to attract the same level of entry.

Outlook for Competition in the SA Retail Gas Market	
Potential entry or expansion in next 5 years	Survey responses indicate that no retailers are planning to enter the SA retail gas market in the next five years, but two existing retailers are planning to expand over this period.
Outlook for competition over the next 5 years	Like NSW, interviewees do not expect any real improvements in competition to occur in the small customer segment of the SA retail gas market over the next five years, given the conditions prevailing in the wholesale gas market and the fact that all the existing capacity on the SEA Gas Pipeline is contracted to 2018. Some also highlighted the potential for competition to stagnate in this market.

[25] See footnote 20.

3.6 Tasmanian retail electricity and gas markets

Table 3.11 and Table 3.12 provide a snapshot of retailers' views on the state of competition in retail electricity and gas markets in Tasmania.

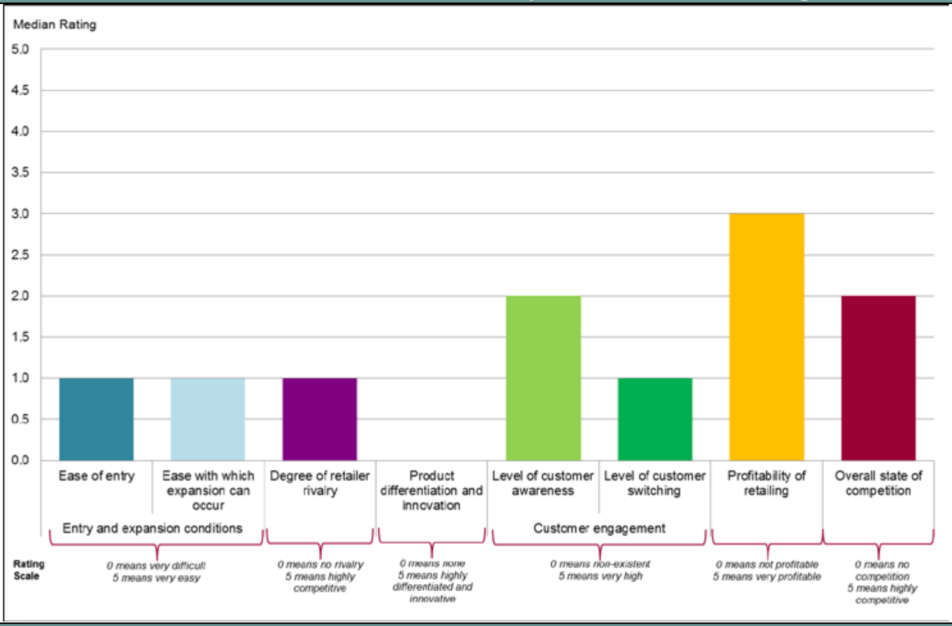
Table 3.11: Tasmanian Retail Electricity Market

<table>
<tr><th colspan="3">Structural and Regulatory Features of the Tasmanian Retail Electricity Market</th></tr>
<tr><td colspan="2">Number of active retailers</td><td>Aurora Energy (owned by the Tasmania Government) is currently the only retailer supplying small customers consuming less than 50 MWh p.a.</td></tr>
<tr><td colspan="2">FRC?</td><td>FRC for small customers takes effect from 1 July 2014</td></tr>
<tr><td colspan="2">NECF in place?</td><td>Yes, since 1 July 2012</td></tr>
<tr><td colspan="2">RPR in place?</td><td>Yes – applied by the Office of the Tasmanian Economic Regulator (OTTER).
As part of the package of electricity market reforms that the Tasmanian Government implemented in 2013, the wholesale contract market in Tasmania is also regulated.</td></tr>
<tr><th colspan="3">Outlook for Competition in the Tasmanian Retail Electricity Market Over the Next Five Years</th></tr>
<tr><td colspan="2">Background</td><td>Because FRC is yet to be rolled out to small customers in Tasmania, the interview questions pertaining to Tasmania primarily focused on the outlook for competition under FRC and whether there are any perceived impediments to entry and/or expansion.</td></tr>
<tr><td rowspan="3">Ease of entry and expansion</td><td>Rating</td><td>In general, interviewees expect it will be difficult to enter the Tasmanian retail electricity market.</td></tr>
<tr><td>Impediments to entry and/or expansion</td><td>Some of the more significant factors that interviewees claimed may impede entry and/or expansion in the Tasmanian retail electricity market include:
RPR, although some interviewees informed us that the allowance OTTER has made for customer acquisition and retention costs and the retail margin in its most recent regulatory decision are conducive to entry.
The wholesale market arrangements and, in particular:
the structure of the market (i.e. a single generator, Hydro Tasmania, that also owns Basslink);
the inability of retailers to rely on interregional hedges to cover their wholesale position; and
the wholesale contract market regulatory arrangements.
With one or two exceptions, retailers viewed the wholesale arrangements as unfavourable and claimed it would be 'difficult to secure a competitive advantage in wholesale supply under the single provider model with all retailers facing the same price'. In contrast to this view, one smaller potential entrant noted that the arrangements would 'at least provide some hedge liquidity' to enable new entrants to compete effectively.
The small size (~250,000 customers) and geographic dispersion of the market.
The nature of the residential customer base, which reportedly has a large number of customers on concessions and/or that have a poor credit history.
Limited awareness amongst customers about their ability to choose their own retailer, given FRC will be in its infancy.
Potential loyalty toward the incumbent government owned retailer. One interviewee took an alternative view on this issue and noted the potential for dissatisfaction with the incumbent retailer to encourage customers to switch.
Jurisdictional billing and regulatory requirements, which, when coupled with the small size of the market, may mean economies of scale are important.</td></tr>
<tr><td>Entry or expansion in next 5 years</td><td>Survey responses suggest that one small retailer may consider entry in the small business segment, while another may consider entry into the residential segment over the next five years. However, neither retailer currently has firm plans to enter.</td></tr>
<tr><td colspan="2">Outlook for competition over the next 5 years</td><td>Based on the interview and survey responses, the outlook for competition in Tasmania is unclear at this point in time. That is, while some small 2nd tier retailers have indicated they may enter this market, they have also noted the risks associated with entry. Other retailers have stated that Tasmania is not currently on their radar and have claimed it would be 'more attractive to expand on the mainland than to enter the Tasmanian retail market'.</td></tr>
</table>

Table 3.12: Tasmanian Retail Gas Market

Structural and Regulatory Features of the Tasmanian Retail Gas Market	
Gas consumption[26]	Gas penetration rate: 6.2% in Hobart and 3.1% in regional areas Total residential demand in 2011-12: 0.1 PJ Average household usage: 11 GJ p.a.
Number of active retailers	2 retailers
NECF in place?	Yes, since 1 July 2012
RPR in place?	No.
Transport & Balancing Models	Contract carriage transportation model. No formal balancing market.

Tasmanian Retail Gas Market Survey Results - Median Ratings



Views on the Current State of Competition in the Tasmanian Retail Gas Market

The overall level of competition in the Tasmanian retail gas market was rated as low by interview and survey participants. The reasons cited for this include:

- There are currently only two retailers operating in this market.
- A number of significant factors discourage entry into this market, including:
  - The small size of the market (estimated to be around 10,000 customers) and the limited scope for growth.
  - The nature of the residential customer base, which reportedly has a large number of customers that are on concessions and/or have a poor credit history.
  - The costs associated with entering into upstream gas and transportation contracting requirements, given the relatively small size of the customer base.
  - The viability of the retail market depends on industrial loads.
- The level of customer awareness and switching in Tasmania are low.

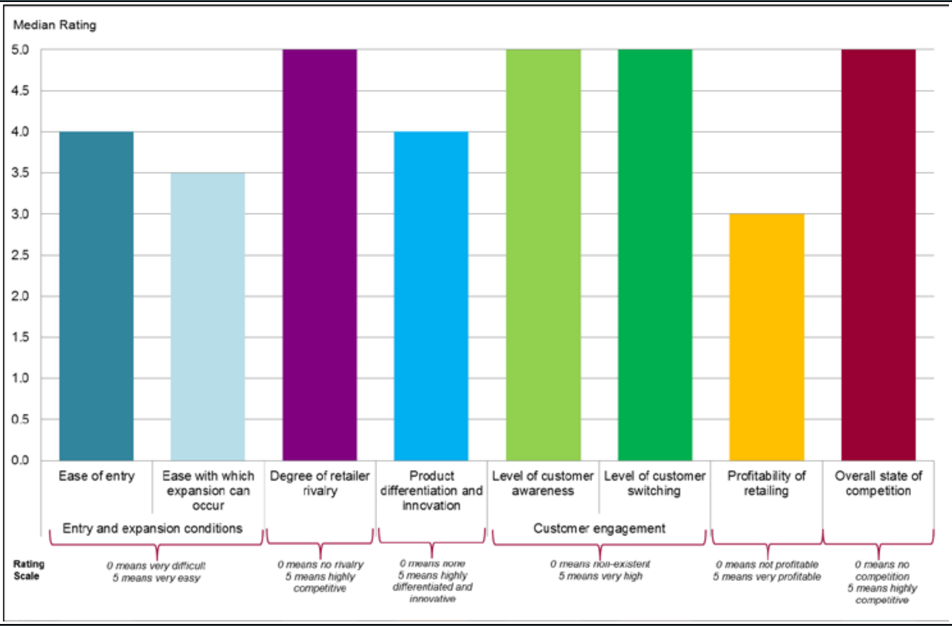
Outlook for Competition in the Tasmanian Retail Gas Market	
Entry or expansion in next 5 years	None of the retailers that were surveyed or interviewed indicated that they plan to enter or expand in the Tasmanian retail gas market over the next five years.
Outlook for competition over the next 5 years	Only one interviewee provided any feedback on the outlook for competition in Tasmania. In short, this interviewee informed us that the Tasmanian retail gas market is ‘shrinking, not growing’ and that if any more large industrial customers are lost ‘there may not be a retail gas market in Tasmania in the next five years’. Increases in wholesale gas prices brought about by the development of LNG facilities are also expected to deter entry.

[26] See footnote 20.

3.7 Victorian retail electricity and gas markets

Table 3.13 and Table 3.14 provide a snapshot of retailers' views on the state of competition in retail electricity and gas markets in Victoria.

Table 3.13: Victorian Retail Electricity Market

<table>
<tr><th colspan="3">Structural and Regulatory Features of the Victorian Retail Electricity Market</th></tr>
<tr><td colspan="2">Number of active retailers</td><td>16 retailers</td></tr>
<tr><td colspan="2">NECF in place?</td><td>No</td></tr>
<tr><td colspan="2">RPR in place?</td><td>RPR removed in 2009. Price monitoring currently in place.</td></tr>
<tr><th colspan="3">Victorian Retail Electricity Market Survey Results - Median Ratings</th></tr>
<tr><td colspan="3">
</td></tr>
<tr><th colspan="3">Views on the Current State of Competition in the Victorian Retail Electricity Market</th></tr>
<tr><td rowspan="2">Ease of entry and expansion</td><td>Rating</td><td>Participants rated entry and expansion in the Victorian market to be relatively easy.</td></tr>
<tr><td>Impediments to entry and/or expansion</td><td>Victoria is considered by retailers to be the preferred entry point for new retailers because RPR has been removed, the level of customer awareness is high and wholesale market conditions have been relatively conducive to entry to date.

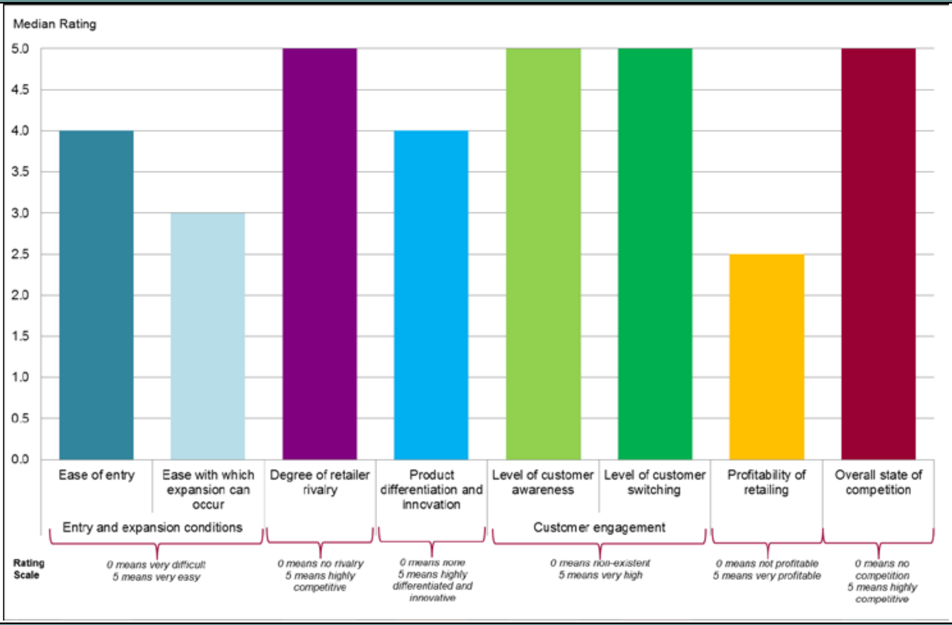
However, interviewees did note the potential for the following factors to affect the ease with which entry and/or expansion can occur in this market:
▪ Recent consolidation in the Victorian wholesale market.
▪ The Victorian wholesale market settlement process, which is now based on actual consumption rather than the net system load profile (NSLP) and has made hedging 'more challenging' for small retailers.
▪ Political and regulatory risk is perceived to be increasing. Factors retailers pointed to in support of this view are: Victoria's failure to sign up to NECF; a 'fervent jurisdictional regulator'; and the implementation of 'onerous' consumer protection provisions. Elaborating further on this, one retailer stated:
'The evidence is that Victoria is a highly competitive market and attractive to retailers. True. But that doesn't mean that governments shouldn't be mindful of announcing significant changes like changes to back billing without any regard to the effect it may have on retailers, because it makes retailers question 'what sort of regulatory change is around the corner?'.
▪ The consumer protection framework, which has been described as more 'onerous' and risky for retailers than other jurisdiction.
▪ The concession schemes in Victorian, which are reportedly more costly to administer.</td></tr>
</table>

Degree of rivalry	**Rating**	Rated as having a high degree of rivalry. In support of this rating, interviewees pointed to the large number of active retailers in Victoria, the high degree of customer switching and a large number of offers. A number of interviewees also observed that discounts in Victoria are significant and customers 'can get a good deal if they shop around'.
	Changes in rivalry over the last two years	Interviewees perceived little change in the degree of rivalry in Victoria over the last two years, with one retailer characterising it has having ranged from 'super hot to mildly hot'. Another larger retailer made the following observation: *'Victoria has for the last four years been the most competitive in the world. It has recently dropped behind NZ by a couple of points but it is still up there as an intensely competitive market and there is no love lost between any of the retailers in the market.'*
Differentiation and innovation		Rated as having a relatively high degree of product differentiation and innovation. Interviewees noted that the removal of RPR, in conjunction with the roll out of smart meters, has paved the way for the development of more innovative products such as Dodo's Free Hour of Power and Powershop's product range. However, interviewees cautioned that regulatory constraints on flexible pricing and the poor quality of some smart meter data may constrain further innovation.
Level of customer awareness		The level of customer awareness in Victoria was rated as high by survey participants. While awareness is reportedly high, two retailers queried why such a large number of customers in Victoria remain on the default standing offer tariff and suggested that more be done to raise awareness amongst this group of customers.
Level of switching		Survey participants rated the degree of switching as high. However, some retailers noted that Victorian customers appear to be becoming disengaged and stated that if 'customer fatigue' sets in, switching rates could drop. Some interviewees noted that with greater emphasis now being placed on retention by the big three and larger 2nd tiers, switching rates could understate the true level of competition in the market.
Profitability of retailing		Electricity retailing in Victoria was rated as moderately profitable by survey participants and more profitable than other jurisdictions. When asked why Victoria is more profitable than other jurisdictions, interviewees stated that prices in Victoria are 'more cost reflective' than they are in other states where prices have been 'artificially constrained' by RPR or voluntary pricing arrangements. Others claim a higher profit margin is required in Victoria because the state's consumer protection framework gives rise to more risks.
Overall state of competition		Overall, Victoria was rated by survey and interview participants as highly competitive. Interviewees attributed this to the following factors: ▪ The time elapsed since privatisation, FRC and the removal of RPR. ▪ Wholesale market conditions have to date been relatively conducive to entry. ▪ The level of customer engagement.
Outlook for Competition in the Victorian Retail Electricity Market		
Potential entry or expansion in next 5 years		Survey responses indicate that six existing retailers are planning to expand in Victoria over the next five years.
Outlook for competition over the next 5 years		Looking forward, retailers expect the Victorian market to remain highly competitive. Concerns have been raised by some though about the effect that customer fatigue may have on the market and have speculated SA or NSW could overtake Victoria. Concerns were also raised about increased concentration in the wholesale market.

Table 3.14: Victorian Retail Gas Market

Structural and Regulatory Features of the Victorian Retail Gas Market	
Gas consumption[27]	Gas penetration rate: 91% in Melbourne and 57.5% in regional areas Total residential demand in 2011-12: 101 PJ Average household usage: 58 GJ p.a.
Number of active retailers	8 retailers operating in the DWGM.
NECF in place?	No.
RPR in place?	No, removed in 2009.
Transport & Balancing Models	Market carriage transportation model in the DWGM and contract carriage in regional pipelines. Balancing occurs through the DWGM.

Victorian Retail Gas Market Survey Results - Median Ratings



Views on the Current State of Competition in the Locations Serviced by the DWGM

The overall level of competition in the locations serviced by the DWGM was rated as high by interview and survey participants. Interviewees attributed this to the following factors:

- The penetration of gas in Victoria is higher than in other jurisdictions.
- There are currently eight retailers operating in this market, five of which are 2nd tier retailers.
- Victoria is considered to be the preferred entry point for gas retailers, because RPR has been removed, the level of customer awareness is high and the design of the DWGM is relatively conducive to entry by small retailers. Interviewees did note though the potential for the following factors to act as an impediment to entry and/or expansion in Victoria:
  - Access to, and/or the price of, gas, given the LNG developments in Queensland and tightening demand and supply conditions in the wholesale gas market.
  - The Victorian Gas Safety Case, which all new retailers must develop and have approved by Energy Safety Victoria (ESV) before they can start retailing, which is reportedly relatively expensive to develop for a 2nd tier retailer.
  - Political and regulatory risk, which is perceived to be increasing.
  - The Victorian consumer protection framework and concession schemes, which have been described as more ‘onerous’, risky and costly than other jurisdictions.
  - The fact that NECF has not yet been adopted.
- The level of customer awareness and engagement is higher in Victoria than other jurisdictions.

[27] See footnote 20.

Views on the Current State of Competition in the Locations Outside the DWGM	
A number of interviewees informed us that the level of competition can be lower in some rural and regional areas of Victoria that sit outside the DWGM (e.g. Carisbrook to Horsham, Mildura and Gippsland) than it is within the DWGM because the capacity of some regional pipelines has been fully contracted; and/or the customer base in these locations is too small to attract the same level of entry.	
Outlook for Competition in the Victorian Retail Gas Market	
Entry or expansion in next 5 years	Survey and interview responses suggest that two 2nd tier retailers are in the process of entering this market and three existing retailers are planning to expand their customer base within the next five years.
Outlook for competition over the next 5 years	Little was said by interviewees about the outlook for the Victorian retail gas market, although some did note that further new entry would prompt a greater degree of rivalry in this market. Some interviewees also noted that while Victoria is in close proximity to large gas reserves, the interconnected nature of the eastern Australian gas market means that retail customers in Victoria will still feel the effect of the tightening demand and supply conditions in the wholesale gas market through higher retail gas prices.

4. Ease of Entry and Expansion

The ease with which a new retailer can enter a market and then expand to a sufficient scale to compete with existing retailers can be an important indicator of the extent to which new entrants and small players are likely to impose a competitive constraint in that market. It can therefore be an important indicator of the effectiveness of competition in a market, which is why it is one of the six criteria the AEMC is required to consider when assessing the state of retail competition.

To help inform the AEMC's assessment of this criterion, interview and/or survey participants were asked to identify:

- any significant impediments to entry and expansion in gas and electricity retail markets across the NEM jurisdictions and to rate the ease with entry and expansion can occur;
- any jurisdictional specific arrangements that may be affecting the ease with which retailers' can expand across multiple jurisdictions; and
- any additional impediments to retailing gas or electricity in rural and/or regional areas.

Interviewees and survey participants were also asked to rate the importance of economies of scale,[28] economies of scope[29] and vertical integration are in gas and electricity retail markets.

A summary of the responses that were provided on entry and expansion conditions is provided in the box below.

Summary: Retailers' perspectives on entry and expansion conditions

Entry and expansion conditions in gas and electricity retail markets

Entry and expansion conditions in both gas and electricity retail markets are perceived to be easiest in Victoria, followed in declining order by SA, NSW, SE Queensland, the ACT, Tasmania and regional Queensland.

Factors impeding entry or expansion

Electricity: The main impediments to entry and/or expansion identified by electricity retailers include: RPR in those jurisdictions where it is still applied; the ability to access competitively priced hedging products (which differs across jurisdictions); prudential and credit support requirements; and political and regulatory risk.

Gas: The main impediments to entry and/or expansion identified by gas retailers include: the 'complex' nature of gas supply arrangements; the small size of some markets; access to some transmission and distribution pipelines; and access to, and/or the price payable for, the wholesale supply of gas.

Impediments to expanding across multiple jurisdictions

Electricity: The ease with which electricity retailers can expand across jurisdictions has purportedly been affected by the delayed implementation of NECF in some states and jurisdiction specific consumer protection and environmental schemes.

Gas: According to some retailers the ease with which gas retailers can expand across jurisdictions has been impeded by differences in the design of balancing markets and transportation carriage models across jurisdictions.

Impediments to entry and expansion in rural and regional areas

Electricity: Retailers cited the following impediments to entry and expansion in rural and regional areas: higher customer acquisition costs; the small size and geographic dispersion of the customer base; and the higher degree of brand loyalty.

Gas: The only other factors that gas retailers claimed could impede entry and expansion in rural and regional areas are: the limited coverage of pipeline networks in rural and regional areas; and the fact that some regional pipelines have been fully contracted.

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28 The term 'economies of scale' refers to a situation where retailer's long run average cost declines as the size of its customer base increases and generally occurs in industries characterised by high fixed or sunk costs.

29 The term 'economies of scope' refers to a situation where the unit cost of supplying two or more products (e.g. a dual fuel product) is lower for a given level of output than if those products were supplied by two separate retailers.

The remainder of this chapter provides further detail on the views expressed by interview and survey participants on the ease with which entry and expansion can occur in electricity and gas retail markets across the NEM jurisdictions.

4.1 Electricity retail markets

4.1.1 Entry and expansion conditions

To elicit retailers' views on the ease with which entry and expansion can occur, interviewees and survey participants were asked:

> How would you rate the ease with which entry and expansion in retail electricity markets can occur in each jurisdiction on a scale of zero to five, where zero means very difficult and five means very easy?

Table 4.1 sets out the median ratings that survey participants assigned to each jurisdiction.

Table 4.1: Ease of Entry and Expansion in Retail Electricity Markets – Median Ratings (0 means very difficult and 5 means very easy)

	ACT	NSW	SE Qld	Regional Qld	SA	Tas	Vic
Entry	2.5	3	2	0	4	1	4
Expansion	0.5	2.5	2	0	3	1	3.5

As the results in this table reveal, Victoria was rated as the easiest market to enter and expand within by survey participants, which is consistent with the observation that was made in a number of interviews that Victoria is the preferred entry point for new entrant electricity retailers. At the other end of the spectrum is regional Queensland, which retailers identified as the hardest market to enter and expand. In between these two extremes sit SA, NSW, SE Queensland, the ACT and Tasmania.

Another interesting point to note from this table is that expansion is considered to be harder than entry in Victoria, NSW and SA. When asked why this is, smaller retailers noted that prudential and credit support requirements can become more significant as retailers expand, while larger retailers claimed that 'vigorous competition in these jurisdictions is acting as a barrier to expansion'. The view that competition can impede expansion was also voiced by a smaller retailer who claimed 'if you grow too fast you'll start a price war with a major'.

To get a better understanding of what retailers believe is impeding entry and/or expansion in these jurisdictions, interviewees and survey participants were asked to identify the most significant impediments to entry and expansion. The impediments they identified include:

- RPR in those jurisdictions where it is still applied;
- the ability to access competitively priced hedging products in some jurisdictions;
- prudential and credit support requirements;
- political and regulatory risk; and
- other regulatory and legislative impediments, including customer protection frameworks, concession schemes and environmental schemes.

The views expressed by interviewees about these impediments are summarised below, while Tables 3.2-3.13 provide further detail on the specific issues raised by interviewees and survey participants about entry and expansion conditions in each jurisdiction. Before moving on though, it is worth noting that while interviewees informed us that the factors set out above can make entry and/or expansion more difficult, larger retailers made it clear that do not constitute insurmountable barriers to entry or expansion.

RPR

RPR and the manner in which it is applied by the jurisdictional regulator was identified by interviewees and survey participants as the most significant impediment to entry and expansion in those jurisdictions it is still applied (i.e. SE Queensland, ACT, Tasmania and NSW until 30 June 2014).

The specific aspects of RPR that interviewees told us can affect entry, expansion and exit decisions are:

- the form the regulated retail price takes (i.e. price control[30] or a weighted average price cap);[31]
- the method used by the regulator to determine the wholesale energy cost allowance;
- the basis on which retail operating costs are determined (e.g. by reference to the host retailer's costs or a new entrant's costs);
- the level at which the retail margin is set; and
- the extent to which any allowance is made for customer acquisition and retention costs.

According to interviewees, the regulated retail prices adopted in recent decisions by IPART in NSW and the OTTER in Tasmania have provided a sufficient margin and headroom to encourage entry and expansion, but decisions by the ICRC in the ACT and the QCA in SE Queensland have not. The specific concerns that interviewees raised about the ICRC and QCA decisions are as follows:

- ACT – Interviewees raised a number of concerns about the ICRC's decision not to make an allowance for customer acquisition and retention costs and to base retail operating costs on ActewAGL's costs rather than a new entrant's costs, and informed us that the approach provides retailers with little or no incentive to enter the ACT market.
- SE Queensland – Interviewees raised a number of concerns about the QCA's treatment of the wholesale energy cost allowance and the Clean Energy Regulator's forecasting errors in recent determinations and noted that these factors had resulted in regulated prices that have been 'biased on the low side' and discouraged new entry. It is worth noting though that interviewees informed us that the QCA's 2014-15 recent draft determination appears to be more conducive to entry and that entry and expansion conditions should improve.

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30 Under this approach retailers can charge no more than the price set by the regulator.

31 Under this approach retailers have some flexibility to rebalance and set prices provided the price cap is not breached.

While the approach employed in NSW and Tasmania was viewed by most as being supportive of entry, interviewees informed us that the mere presence of RPR in these jurisdictions still constitutes a risk to retailers. Elaborating further on this, interviewees stated that even if the jurisdictional regulator makes provision for a reasonable retail margin and 'headroom'[32] in one decision, there is always a risk that in the next decision it will change its approach and either exclude any headroom allowance, or worse still, set the regulated price below the retailer's cost of supply. It is this risk that retailers informed us can deter entry and expansion.

Ability to access competitively priced hedging products

Constraints on the ability of retailers to access competitively priced hedging products came a close second to RPR in terms of the perceived impediments to entry and expansion.

Not surprisingly, conflicting views were expressed about the significance of this impediment. On the one hand, larger vertically integrated retailers claimed that there is sufficient liquidity in hedging markets and that they are likely to be become even more liquid with recent losses of large industrial loads. Smaller retailers, on the other hand, noted that there have been constraints on the availability of competitively priced hedging products in some jurisdictions and that this can:

- constitute a significant barrier to entry and expansion in the relevant jurisdiction; and
- place retailers without generation interests at a competitive disadvantage *vis-à-vis* the vertically integrated retailers in the relevant jurisdiction.

The views expressed by some smaller retailers on this issue are set out below:

> *'Whilst liquidity in the standard wholesale market and futures products remains reasonable, there are now very few entities left in the market with the motivation to market products that allow a small retailer to reduce their cost to serve. Hedging a retail load with the standard peak/off-peak futures products is expensive so this cost has to be passed on to the customer. Integrated utilities meanwhile have access to flexible generation so their cost to serve is lower.'*
>
> *'If there was a really good secondary market for hedging it wouldn't be such an issue, but at the moment the market is very illiquid and you end up paying higher prices than what you should compared to what the vertically integrated retailers are getting as a transfer price. The problem is more acute in SA. You just have to look at the futures market now and you can't get quarterly hedges more than a couple of quarters out. Victoria is not as bad, but the spread is still quite high. If you want to deal in the OTC market as a small player, you have a credit gap to pay and it is tougher to get decent prices.*
>
> *More fundamentally, I have problems with the futures market because there is insufficient liquidity in some parts of the futures market, the product mix isn't right, information flows are poor and the minimum transaction level is too high.'*

[32] The term 'headroom' is used to refer to an additional allowance, on top of the retail margin, to encourage competition (e.g. customer acquisition and retention costs).

The jurisdiction that smaller retailers identified as being most affected by constraints on the availability of competitively priced hedging instruments was SA. Concerns were also raised about the potential for issues to arise in other markets as jurisdictional wholesale markets become more concentrated and some governments look to privatise their generation assets. The specific concerns raised about each jurisdiction are set out in Table 4.2.

Table 4.2: Views on Access to Hedging Products Across Jurisdictions

Jurisdiction	Summary of observations
SA	Interviewees informed us that access to hedging products is a significant issue in SA because: ▪ wholesale prices in this market can exhibit a significant degree of volatility when the interconnector goes down; ▪ retailers are unable to rely on interregional hedges and the extent to which a retailer can rely on futures products in SA is 'questionable' because the market for SA futures products is reportedly 'highly illiquid and only provides coverage for a couple of quarters'; and ▪ the ownership of non-renewable generation in SA is highly concentrated and wind reportedly 'doesn't cut it as a hedging instrument in SA'.
NSW	The ability to access hedging products in NSW has not been viewed as a significant issue to date, because while retailers have reportedly experienced difficulties entering into hedging contracts with the NSW Government owned generators, they have been able to overcome this impediment by relying on interregional hedges, financial intermediaries and/or the futures market. Concerns were raised though by a small number of retailers about the potential for this to change in the future, if AGL acquires Macquarie Generation. This view was not universally held though, as the following comments from two small interviewees highlight: *'If AGL doesn't acquire Macquarie Generation, AGL would eventually reach a maximum number of customers that it could service without having generation and this could adversely affect competition. That is, because Origin and EnergyAustralia would be the only retailers able to compete at the larger scale, which, in effect, would result in a duopoly in the state. Such an outcome could be worse for customers'.* *'If AGL acquires Macquarie Generation there will be scraps and crumbs for smaller players, but not enough access to hedging instruments to underpin a fourth big player.'*
Queensland	The ability to access hedging products in Queensland has not been viewed as a significant issue to date because the government owned generators have reportedly been more commercial than their NSW counterparts in terms of being prepared to enter into hedging contracts with smaller retailers. Concerns have been raised though about the potential for this to change in the future if Stanwell and CS Energy are privatised and sold to vertically integrated retailers, because the Queensland wholesale market is reportedly becoming more akin to SA in terms of volatility and interconnector constraints. These concerns are reflected in the following statement: *'If the wholesale market is functioning properly it is not necessary, but I do worry about Queensland and particularly when the generators are sold and who they are sold to and how independent retailers are supported given the concentration in the wholesale market. That is a key issue in South Australia, which is also an islanded market. It is obvious to me that you need an appropriate mechanism to ensure small independent retailers can access hedging contracts, otherwise it will affect retail competition.'*
Tasmania	With the impending implementation of FRC in Tasmania, interviewees were asked whether access to hedging products was likely to be an issue for any new players that decide to enter this market. With one or two exceptions, retailers informed us that the following aspects of the wholesale arrangements would discourage entry because they claim it would be 'difficult to secure a competitive advantage in wholesale supply under the single provider model with all retailers facing the same price': ▪ the structure of the market (i.e. a single generator, Hydro Tasmania, that also owns Basslink); ▪ the inability of retailers to rely on interregional hedges to cover their wholesale position; and ▪ the wholesale contract market regulatory arrangements. Some of these retailers went on to add that 'it would have been better if Hydro Tasmania had been split in two'. In contrast to this view, one smaller potential entrant noted that the wholesale contract market arrangements would 'at least provide some hedge liquidity' to enable new entrants to compete.
Victoria	Interviewees informed us that gaining access to hedging products had not been an issue to date in Victoria, because the ownership of generation interests in Victoria has been relatively diverse. Concerns were raised though by some smaller retailers about the potential for this to change going forward given the recent increase in concentration in the Victorian wholesale market. This view was not shared by larger retailers, who noted that the loss of some significant loads in Victoria would provide generators with 'every incentive to enter into hedging contracts'.

Prudential and credit support requirements

Smaller retailers that participated in the interview and survey noted that the prudential arrangements and credit support required by AEMO, generators, financial intermediaries, the ASX and electricity networks can be a significant impediment to entry and expansion, because they ‘involve a significant capital outlay and tie up growth capital’.

Further insight into smaller retailers’ views on these requirements can be found in the following statements:

> *‘AEMO’s prudential requirements and the credit support required by generation counterparties (usually cash-backed bank guarantees) ties up growth capital for small retailers. Small retailers will often have to put up quite a serious percentage of their energy turnover, usually about half of its bill, just in bank guarantees.’*

> *‘AEMO’s prudential requirements act as a significant capital drain for retailers. In Queensland the government owned generators either want an onerous upfront provision or want a credit support annexure, which can be an issue for smaller players.’*

> *‘Both AEMO and the ASX require credit support in the form of margining and bank guarantees. A retailer who buys futures to hedge a physical position with AEMO has to post a margin with both the ASX and AEMO on the gross rather than net position. This significantly limits the retail load a new entrant can serve within reasonable risk limits.’*

Political and regulatory risk

Political and regulatory risk is another factor that interviewees informed us can impede entry and/or expansion. In short, interviewees informed us that a perception of high political and/or regulatory risk in a particular jurisdiction can affect a retailer’s confidence in that market and, in turn, its decision to either enter that market, or to actively compete if it is an existing player.

The two jurisdictions that interviewees identified as having the highest degree of political and/or regulatory risk at present are:

- *Queensland* – Interviewees informed us that the decision by the Queensland Government to freeze prices in 2012-13 had ‘destroyed’ retailers’ confidence in this market and resulted in some retailers ceasing to actively market and some prospective new entrants abandoning plans to enter the SE Queensland market.
- *Victoria* – Interviewees informed us that political and regulatory risk is increasing in Victoria and pointed to the following factors in support of their view:
  - Victoria’s failure to sign up to NECF;
  - the Victorian Government’s recent implementation of ‘onerous’ consumer protection provisions, such as those pertaining to back billing; and
  - a ‘fervent jurisdictional regulator’.

Elaborating further on this, one retailer stated:

> *'The evidence is that Victoria is a highly competitive market and attractive to retailers. True. But that doesn't mean that governments shouldn't be mindful of announcing significant changes like changes to back billing without any regard to the effect it may have on retailers, because it makes retailers question 'what sort of regulatory change is around the corner?'*

Other regulatory and legislative impediments

One of the more significant legislative impediments to entry that interviewees identified was the Uniform Tariff Policy (UTP) in regional Queensland. Retailers informed us that this policy is preventing competition emerging in regional Queensland because:

- retailers are unable to supply electricity at the same price they are able to in SE Queensland (i.e. because transmission and distribution costs are higher); and
- unlike Ergon Retail (and Origin in some defined areas), they are not entitled to any of the subsidy the Queensland Government pays to maintain the UTP.

Jurisdictional energy efficiency schemes were also identified as a potential impediment to entry and expansion. The scheme that attracted most attention in this context was the SA Residential Energy Efficiency Scheme (REES), which imposes an obligation on retailers supplying 5,000 or more customers. A number of small retailers informed us that the 5,000 customer threshold is too low and, as noted in the following statement, can impose significant costs on small retailers because it is not a tradable scheme:

> *'For a new entrant retailer, the scheme can impose significant costs if the retailer has only just reached the threshold because at that size it has little negotiating power when contracting out the services and will also be unable to benefit from any economies of scale. This differs from a tradable scheme where the price paid by retailers doesn't depend on the size of the retailer.'*

4.1.2 Impediments to expanding across multiple jurisdictions

In addition to the impediments outlined above, interviewees informed us that the following factors are acting as an impediment to retailers operating across, or seeking to operate across, multiple jurisdictions:

- *Delays in the implementation of the NECF and jurisdictional derogations* – Interviewees raised a number of concerns about the decision by some jurisdictions to delay the implementation of NECF. According to interviewees, these delays have resulted in some retailers delaying their entry into these jurisdictions and led to higher costs for those retailers operating across adoptive and non-adoptive jurisdictions. Concerns were also raised about the number of jurisdictional derogations that have been implemented, with interviewees stating that the derogations are resulting in substantially higher costs for retailers operating across multiple jurisdictions.
- *Differences in energy efficiency schemes and feed-in tariff schemes across jurisdictions* – Interviewees noted that differences in these schemes are 'adding to the costs and complexities faced by retailers that are operating across jurisdictions'. While some

interviewees suggested that jurisdictional schemes should be harmonised, others cautioned against it because they ‘fear it will become like the NECF process’.

- *Differences in customer protection frameworks and concession schemes across jurisdictions* – Interviewees noted that differences in customer protection frameworks (i.e. hardship schemes and regulations pertaining to wrongful disconnection, back billing and collections) and concession schemes across jurisdictions can give rise to higher costs and risks and queried whether there was a need for such differences. The Victorian framework was viewed by interviewees as being particularly ‘onerous’ and a potential impediment to expansion into this jurisdiction.
- *Differences in other regulatory requirements across jurisdictions* – Interviewees raised concerns about the effect that differences in other regulatory requirements across jurisdictions (e.g. jurisdictional billing requirements) can have on the costs and risks faced by retailers and to act as an impediment to expansion across jurisdictions.

In the course of this discussion, we asked interviewees whether the implementation of NECF had been beneficial. The common response to this question was that it has been beneficial in those jurisdictions it has been adopted. Concerns were raised though about whether the efficiency benefits that were originally envisaged would actually be achieved, given all the jurisdictional derogations. Some interviewees also informed us that NECF should *not* be viewed as a means to an end and that once harmonisation is achieved across the jurisdictions, the framework needs to be simplified.

4.1.3 Impediments in rural and regional areas

To ascertain whether there are any additional barriers to retailing electricity in rural and regional areas, survey participants were asked to state whether there are any such impediments. While most survey participants stated that there were none, a number of interviewees informed us that the following factors can deter entry in these areas:

- the relatively small size and geographic dispersion of the customer base in these areas;
- higher customer acquisition costs in rural and regional areas, particularly if the retailer uses door knocking to attract new customers; and
- brand loyalty and the value customers in rural and regional areas place on dealing with a retailer that has a community presence.

4.1.4 Importance of economies of scale and scope, and vertical integration

In some markets, a retailer’s ability to effectively compete with its rivals will depend on whether it is able to access economies of scale, economies of scope or to minimise its exposure to input cost risks or supply risks by being vertically integrated. To get retailers’ perspectives on the significance of these factors in electricity retailing, interviewees were asked to explain how important economies of scale, economies of scope and vertical integration are in terms of being able to effectively compete in each jurisdiction. Their responses are summarised below.

Economies of scale

Conflicting views were expressed by interviewees about the importance of economies of scale, with some claiming it is important, while others claimed it is of limited importance. Both of these groups consisted of large retailers and smaller second tiers, so the positions taken on this issue do not appear to be related to the size of the retailer.

The group of interviewees that stated economies of scale are important noted that they tend to be associated with the costs of running call centres and the costs of billing, settlement and other IT systems. Some interviewees also claimed there is a minimum load that a retailer requires to enter into appropriate hedging arrangements.

The group of interviewees that claimed they are of limited importance, on the other hand, stated that:

- smaller retailers can access economies of scale by outsourcing some of their functions (e.g. call centre and billing services); and
- generators can provide flexible hedging cover for small players and small parcels of cover are available through the futures market.

When asked if there is a minimum load required in a particular jurisdiction to make entry viable in that jurisdiction, interviewees stated that, with the exception of the ACT and Tasmania, there generally isn’t. In relation to the ACT and Tasmania, interviewees informed us that jurisdictional specific arrangements (e.g. billing requirements and different network tariff structures), coupled with the very small size of these market, can mean that economies of scale are far more important in these jurisdictions.

Economies of scope

Interviewees held mixed views about the importance of economies of scope in electricity retailing. That is, while some interviewees claimed it is an important source of efficiency in terms of customer acquisition costs (i.e. two revenue streams from the same level of market expenditure), others claimed that supplying dual fuel or multi-utility products is just a form of product differentiation (or retention strategy) and doesn’t give rise to any cost efficiencies.

Those interviewees that claimed economies of scope are important noted that its importance can differ across jurisdictions, and that it tends to be more important in those jurisdictions with a higher gas penetration rate (e.g. Victoria and the ACT).

Vertical integration

In a similar manner to the access to hedging products debate, interviewees held mixed views about the importance of having generation interests.

On the one hand were larger retailers with generation interests, who claimed that vertical integration is not important and that there is sufficient hedge cover available to those that do not have generation interests. In the words of one of these retailers:

> *'The absence of vertical integration hasn't been seen to inhibit competition to date'.*

On the other hand were smaller retailers (including small gentailers), who claimed that it is becoming increasingly important to have generation interests given the increased concentration of ownership in the wholesale market. This group added that having generation interests in those jurisdictions that can be subject to interconnector constraints (e.g. SA, Queensland and Tasmania) is of particular importance, given the wholesale price volatility that can ensue once supply to the market is constrained. The views of this group of retailers are captured in the following statements made by two small retailers:

> *'Vertical integration is more important now given the changes in the wholesale market and reduced liquidity in the hedging market. If there was a really good secondary market for hedging it wouldn't be such an issue, but at the moment that market is very illiquid so non-integrated retailers end up paying higher prices than what they should compared to what the vertically integrated retailers are getting as a transfer price. The problem is more acute in SA.'*

> *'If the wholesale market is working properly, vertical integration is not necessary. But as markets become more concentrated it will become an issue, particularly in Queensland and South Australia, both of which can become islanded.'*

One other point that was raised by both a small and large gentailer is that vertical integration can be more important if a retailer wants to expand beyond a certain scale. Elaborating further on this issue, the small gentailer made the following observation:

> *'You can build a retail business without being vertically integrated, but at a certain point you reach a cap and so the business either remains at that level, or is sold to another retailer with generation coverage. Otherwise that retailer becomes too susceptible to wholesale market volatility.'*

4.1.5 Exit conditions

In some industries, the costs of exiting a market can be significant and may deter new entrants. To determine whether this is an issue in electricity retailing, survey participants were asked to rate the ease with which exit can occur.

With the exception of host retailers who in principle should not be exiting the market, survey participants rated exit as being relatively easy. Exit costs do not therefore appear to be a significant issue for electricity retailers.

4.2 Gas retail markets

4.2.1 Entry and expansion

In a similar manner to electricity, interviewees and survey participants with gas retailing interests were asked:

> How would you rate the ease with which entry and expansion can occur in gas retail markets in each jurisdiction on a scale of zero to five, where zero means very difficult and five means very easy?

Table 4.3 sets out the median ratings that survey participants assigned to each jurisdiction.

Table 4.3: Ease of Entry and Expansion in Gas Retail Markets – Median Ratings (0 means very difficult and 5 means very easy)

	ACT	NSW	SE Qld	Regional Qld	SA	Tas	Vic
Entry	1.5	3	2	0	3	1	4
Expansion	0.5	2.5	2	0	3	1	3

Like electricity, the Victorian retail gas market was rated as the easiest market to enter and expand by survey participants, which is consistent with the view expressed by a number of interviewees that the DWGM is more conducive to entry by small retailers than other markets, including the STTM (see Box 4.1). At the other end of the spectrum is regional Queensland, which is perceived to be the hardest market to enter and expand.[33] In between the two extremes sit SA, NSW, SE Queensland, the ACT and Tasmania.

Box 4.1: DWGM vs STTM

The retailers that we spoke to about the DWGM (Victoria) and the STTM (Sydney, Adelaide and Brisbane) informed us that the DWGM is more conducive to entry by smaller retailers, because:

- they don't need to enter into long term gas transportation agreements; and
- they can purchase gas from the market while they are building up their customer base.

While in principle, small retailers operating in the STTM should also be able to purchase gas directly from the market while they are building up a customer base, interviewees informed us that the risks in the STTM are such that new entrant retailers have tended not to rely on this option, preferring instead to enter into gas supply and transportation contracts.

To get a better understanding of what retailers believe is impeding entry and/or expansion in these jurisdictions, interviewees and survey participants were asked to identify any impediments in the jurisdictions that they are currently operating in and/or are in the process of entering. Some of the more significant impediments that interviewees identified were:

- the complex nature of the bilateral arrangements underpinning the retail supply of gas;

[33] It is worth noting in this context that the UTP only applies to electricity, so the difficulties observed in regional Queensland cannot be attributed to this policy.

- the small size of some markets;
- access to pipelines that are fully contracted (or close to fully contracted);
- access to, and/or the price payable for, the wholesale supply of gas;
- the costs and risks associated with managing demand variability;
- the Victorian Gas Safety Case; and
- RPR in NSW.

The views expressed by interviewees about these impediments are summarised below, while Tables 3.2-3.13 provide further detail on the specific issues raised by interviewees and survey participants about entry and expansion conditions in each jurisdiction.

Complexity of supply arrangements

One of the more significant factors that smaller retailers claimed can deter entry into retail gas markets is the ‘complex’ and bilateral nature of the gas supply, transportation and storage arrangements underpinning the retail supply of gas. The perceived complexities of these contractual arrangements and the imbalance markets overlaying these bilateral arrangements are captured in the following statement, which was made by a relatively new entrant into the gas retail market:

> *‘You should just be able to be a pure retailer and buy gas from the pool and use financial instruments to manage your risk exposure, which is how things work in electricity. Instead, you have to deal with a physical product and enter into specific agreements for everything, like gas supply, transportation, pipeline storage, underground storage, LNG storage and other risk management products. All of these arrangements do completely different things, have different pricing structures and involve different entities, so you need to negotiate everything separately. On top of that, you have to participate in either the DWGM or the STTM in the major hubs. It’s just needlessly complicated and puts new entrant retailers off.’*

Size of the market

The relatively small size of some markets is another factor that interviewees informed us has affected entry and expansion decisions in jurisdictions like Tasmania, Queensland and the ACT and in rural and regional areas. Elaborating further on this point, a number of interviewees informed us that the costs of entering into all of the supply arrangements outlined above can be significant and can therefore discourage entry into small markets. As one interviewee noted:

> *‘The costs of entering into gas supply, transportation and storage contracts, and participating in imbalance markets are high. When coupled with the fact that the pricing structures adopted by producers, pipeline and storage owners tend to be predominantly fixed in nature, it is not surprising that retailers think twice about entering small markets or that in some markets you only see a couple of retailers.’*

Access to contracted pipelines

In a number of interviews, retailers told us that if the capacity of a transmission or distribution pipeline is fully contracted (or close to fully contracted), it can deter entry and/or expansion in that market, because the costs of expanding the capacity of a pipeline can be significant and retailers 'are unable to rely on interruptible services as their primary transportation service'. Two transmission pipelines that retailers informed us are currently in this position are:

- the SEA Gas Pipeline, which enables gas to be supplied from Victoria to SA; and
- the Eastern Gas Pipeline (EGP), which enables gas to be supplied from Victoria to NSW.

Some retailers also informed us that transporting gas in a westerly direction from the Gippsland Basin to the entry point of the SEA Gas Pipeline can be difficult and is limiting the supply options available to retailers seeking to supply gas to SA.

As the LNG developments in Queensland cause more gas from the Cooper and Bowen/Surat basins to be drawn to Gladstone and NSW and SA become more reliant on gas supplied from Victoria, these pipeline constraints are expected to become more of an issue.

In addition to these constraints, interviewees told us that a number of regional pipelines in SA, NSW, Queensland and Victoria (outside the DWGM) have been fully contracted (or are close to fully contracted).

Access to, and/or the price payable for, the wholesale supply of gas

According to interviewees, the effects of tightening demand and supply conditions in the wholesale gas market, brought about by the development of LNG facilities in Queensland, are starting to be felt by retailers. When asked how conditions in the wholesale gas market are likely to affect entry and/or expansion decisions, interviewees noted the following:

- While retailers are currently able to access gas, the price payable for this gas is substantially higher than it has been historically, with prices in some jurisdictions converging toward the LNG netback price.
- The effect of higher prices have to date been felt most acutely in Queensland (because of the close proximity of this market to the LNG facilities), but the effect is starting to be felt in other markets, including NSW and SA, which have been historically reliant on gas supplied from the Cooper Basin (northern SA and south west Queensland) and the Bowen/Surat basins (Queensland).
- The price payable by retailers for the wholesale supply of gas will depend on when they entered into their gas supply contract and/or when their contract was last subject to a market based price review (typically every three to five years). The price payable for gas can therefore vary markedly across retailers at any point in time. In a rapidly rising market, the differences can be more pronounced and can adversely affect the competitive position of those retailers that are exposed to the higher pries first.

- There is a considerable degree of uncertainty about how conditions in the wholesale market will play out over the next five years, which interviewees told us could deter new entry and expansion in some jurisdictions until conditions become clearer.

Some of these perspectives are reflected in the following statement made by a larger retailer:

> *'The reality is if you are trying to secure a gas supply contract in Queensland right now you are competing with the three LNG projects, so you will have to pay more for gas. That's the reality and it may be a long term or short term issue, it's hard to know at this time.*
>
> *If anyone wants to get gas they can get it, but it depends on the price you are willing to pay. There is no shortage; it all comes down to the price you are willing to pay. So if an international buyer wants to pay $10 for LNG but a retailer is willing to pay $11, the gas will stay here. That's how the market works.'*

Risks and costs of managing demand variability

A number of smaller retailers informed us that when starting out a gas retailer can be subject to a significant degree of variability in demand, because their customer base is quite small and they are unable to diversify this volume risk in the same manner as larger retailers. While there are mechanisms in gas supply and transportation contracts that retailers can use to manage this risk,[34] this group of retailers informed us that they can be quite costly to implement, so a new entrant's cost to serve can be substantially higher than those incurred by a larger retailer.

Victorian Gas Safety Case

Before a gas retail licence can be granted in Victoria, a retailer must develop a Gas Safety Case and have it approved by Energy Safety Victoria (ESV). Two recent entrants and two retailers that are in the process of entering the Victorian gas retail market informed us that the gas safety case is impeding entry into this market because it is 'unduly difficult, time consuming and costly'. In support of this claim, this group of retailers noted that:

- the safety case process delayed the entry of two of the retailers by over four months and is expected to delay the entry of the other two retailers by a similar length of time; and
- one retailer spent over $100,000 developing its gas safety case.

In the course of discussing the gas safety case, a number of interviewees questioned the value of having retailers develop a gas safety case, with one retailer noting that:

> *'…safety related risks primarily stem from the wholesale and transportation parts of the supply chain and are beyond the control of retailers, so it is unclear why we need to develop a gas safety case.'*

[34] For example, a retailer could enter into a gas supply contract with a high load factor or include a storage service in its transportation contract with the relevant transmission pipeline.

4.2.2 Impediments to expanding across multiple jurisdictions

When asked if there are any additional impediments to expanding across multiple jurisdictions, interviewees informed us that delays in the implementation of NECF and jurisdictional customer protection frameworks have influenced some gas retailers' decisions to expand into gas retail markets in other jurisdictions. The delayed implementation of NECF in Victoria was viewed as particularly problematic because of the differences that now exist between the licence requirements in Victoria and the NECF authorisation requirements applying in other jurisdictions.

Some smaller retailers also noted that differences in the design of balancing markets (i.e. the STTM in Adelaide, Sydney and Brisbane and the DWGM in Victoria), retail markets and transportation models (i.e. market carriage in the DWGM and contract carriage elsewhere) can make it more difficult for small retailers to expand across jurisdictions. This point is reflected in the following statement made by a relatively new entrant gas retailer:

> *'It astounds me how unnecessarily complex it is to retail gas and the number of differences that retailers have to deal with both within and across jurisdictions in terms of market design, transmission models, distribution network requirements, retail market design and regulatory requirements. It just makes it so hard for new entrants. The complexities are such that you need to hire at least two people to deal with it all. While this may not be a significant issue for the big three, it is a significant cost for new entrants.'*

Larger retailers, on the other hand, didn't consider these differences to be an issue, with one retailer stating:

> *'I don't see differences in market design as making a fundamental difference to whether a retailer decides to participate, or the extent to which it participates. Each market comes with its own set of risks, but they aren't significant enough to result in a 'no go' decision.'*

4.2.3 Impediments in rural and regional areas

To determine whether gas retailers face any additional impediments when trying to enter and/or expand in rural and regional areas, survey participants were asked to state whether there are any impediments in the jurisdictions they operate.

Of the seven survey participants that responded to this question, five stated that it can be more difficult to enter and expand in rural and regional areas of NSW, Queensland, SA and outside the DWGM in Victoria. The difficulties were primarily attributed to the following:

- the limited coverage of pipeline networks in rural and regional areas;
- the capacity of some regional pipelines has been fully contracted by either a single retailer or a very small number of retailers; and
- the small size of the customer base in these areas, because as one retailer noted:

  > *'Economies of scale can be significant for gas retailers and region specific given the fixed cost nature of most wholesale gas supply and transportation agreements.'*

Interviewees also noted that brand loyalty and higher customer acquisition costs in rural and regional areas can deter entry in these areas.

4.2.4 Importance of economies of scale and scope, and vertical integration

An overview of the views expressed by interviewees about the importance of economies of scale, economies of scope and vertical integration in gas retailing is provided below.

Economies of scale

In relation to economies of scale, interviewees informed us that:

- economies of scale are more important in gas retailing than they are in electricity retailing, because the pricing structures specified in gas supply and transportation contracts are predominantly fixed; [35] and
- economies of scale tend to be regional or jurisdictional specific given the fixed costs associated with transporting gas to particular locations.

While economies of scale are considered more important in gas retailing, interviewees made it clear that they do not constitute an insurmountable barrier to entry.

Economies of scope

Like electricity, interviewees held mixed views about the importance of economies of scope in gas retailing (see section 4.1.4). However, most interviewees noted that, with the exception of Tas Gas Retail in Tasmania, there are *no* pure gas retailers operating in the NEM jurisdictions. This observation would tend to suggest that economies of scope are more important in gas retailing than they are in electricity retailing.

Vertical integration

Interviewees expressed mixed views about the importance of having interests in upstream gas production. That is, while some interviewees claimed it is becoming increasingly important given the LNG developments in Queensland and rising wholesale gas prices, others claimed it is unnecessary and that all a retailer needs to do is enter into a gas supply contract with either a producer or an aggregator. Those retailers that we spoke to that have upstream interests informed us that gas production and exploration is a completely different business to gas retailing and there are 'limited synergies between the two'.

4.2.5 Exit conditions

In a similar manner to the electricity survey, gas survey participants were asked to rate the ease with which exit can occur in gas retail markets.

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[35] For example, wholesale gas supply contracts tend to have relatively high take or pay provisions (e.g. 80-100% of the annual contract quantities), which means that a retailer has to pay for a minimum volume of gas, irrespective of whether or not it takes supply of that gas. In the case of transportation services, the price payable for firm transportation on contract carriage pipelines is predominantly based on the capacity of the pipeline that the retailer has reserved (i.e. $/GJ of reserved Maximum Daily Quantity), which means the retailer has to pay for that capacity, irrespective of whether or not it actually uses all of that capacity,

The responses to this question were diverse, with some rating it as difficult while others rated it as very easy. Those participants that rated it as difficult noted that take or pay commitments in gas supply contracts and capacity based charges in transportation contracts can make it costly and difficult for retailers to wind back, or completely exit the market.

While the participants that rated exit as very easy acknowledged that these features of gas supply and transportation contracts can be an impediment, they claimed that a retailer seeking to wind back its activities could on-sell some of its gas or transportation contract, or novate its contracts to another player in the market.

5. Products, Marketing and Retention Strategies

To help inform the AEMC's assessment of the way in which gas and electricity retailers compete and interact with prospective and existing customers, interview and survey participants were asked a series of questions about:

- the types of products that gas and electricity retailers offer;
- how gas and electricity retailers try and differentiate their products and the extent to which there has been any product innovation across the NEM;
- the marketing strategies that gas and electricity retailers employ and the types of customers they try to target when marketing to prospective customers; and
- the strategies that gas and electricity retailers use to try and retain existing customers.

The box below summarises the responses provided on each of these question areas.

Summary: Retailers' perspectives on products, marketing and retention strategies

Product offerings

Gas and electricity retail products currently are sold to residential and small business customers on a single fuel, dual fuel or multi-utility basis and under either a fixed term contract or an evergreen contract. The price and other terms and conditions upon which these products are sold can differ across retailers. So too can the price and non-price inducements retailers use to attract and/or retain customers.

Some electricity retailers also offer feed-in products to customers with solar panels and a flexible pricing (time of use) product to customers with an interval or smart meter.

Product innovation

Electricity: Retailers noted there has been limited innovation in electricity retail markets to date, but stated that the roll out of smart meters in Victoria is paving the way for more innovative products. Retailers cautioned though that innovation may be impeded by regulatory constraints on flexible pricing and data quality issues. Other impediments to innovation that retailers cited include: metering infrastructure outside Victoria; network tariff structures; RPR in jurisdictions where it is still applied; other regulatory constraints; and limited customer interest.

Gas: Retailers claim there has been even less product innovation in gas retail markets, which retailers attributed to metering limitations and the relatively low level of interest exhibited by gas customers.

Marketing strategies

Marketing is generally undertaken by gas and electricity retailers to advertise specific offers, or build up brand awareness, and may occur through a variety of channels (e.g. direct forms of contact, online channels, mass media and other channels), which either target particular customer segments or the broader market.

In terms of customers targeted, interviewees referred to some retailers using credit checks to avoid customers with a poor credit history, but this practice reportedly is not widespread. Larger retailers also appear to be engaging in some degree of customer segmentation by offering different products through channels that target different customer types (e.g. customers focused on convenience rather than price).

Retention strategies

Retention strategies are generally used by retailers to try and limit the number of customers that switch to another retailer and can take a variety of price and non-price forms. Greater emphasis is reportedly being placed on these types of strategies by host and larger second tier retailers as a means of reducing the cost of churn.

The remainder of this chapter provides further detail on the views expressed by interview and survey participants about product offerings, product differentiation and innovation, and the marketing and retention strategies employed by retailers.

5.1 Product offerings

The questions that interview and survey participants were asked about product offerings were designed to elicit their views on:

- the types of products that gas and electricity retailers offer to residential and small business customers;
- the role that dual-fuel and multi-utility products play and the perceived importance of these products across the NEM; and
- the extent to which customer preferences influence a retailer's product offerings.

The responses to these three questions are outlined below.

5.1.1 Product features

Gas and electricity retail products currently are sold to residential and small business customers on a single fuel, dual fuel (i.e. gas and electricity) or multi-utility (e.g. gas, electricity and internet) basis and under either a fixed term contract or an evergreen contract. The price and other terms and conditions upon which these products are sold can vary substantially across retailers. So too can the discounts, rebates and non-price inducements that retailers use to attract and/or retain customers.

To gain additional insight into these differences, interviewees were asked to describe how these product features can differ across retailers. Their responses are summarised below:

- *Prices* – The specific aspects of the contract price that interviewees informed us can differ across retailers include:
  - *The retail tariff structure* – Interviewees noted that while the retail tariff structure usually mirrors the network tariff structure (e.g. single rate, two rate (off peak and peak) or time of use for customers with an interval or smart meter), there have been occasions where retailers have offered customers alternative structures.
  - *The benchmark retailers use for their market offers* – Interviewees noted that in jurisdictions that still apply RPR, the benchmark is usually the regulated tariff, while in other jurisdictions the benchmark tends to be based on the retailer's standing offer.
  - *The extent to which tariffs can be adjusted to reflect changes in the retailer's costs* – Interviewees informed us that at one end of this spectrum are fixed price contracts, which prevent any change over the contract term, while at the other end are contracts that enable the retailer to pass on any change in wholesale, network and retail operating costs to customers. In between these two extremes are contracts where the

retailer only passes on uncontrollable costs, like network charges, government taxes and imposts and changes in inflation.

- *Price inducements* – The types of price related inducements that interviewees informed us are being offered include:
  - *Discounts* – Interviewees noted that discounts typically take the form of a percentage discount, although there have been examples of retailers incorporating the discount directly into their market offer tariffs. Interviewees also informed us that:
    - the discounts may be conditional or non-conditional and can be offered for a number of reasons, including where the customer commits to: a fixed term contract; paying its bill on time and/or agreeing to pay by direct debit; and purchasing gas and electricity (or a multi-utility product) from the same retailer;
    - the level of the discount and the basis on which it is paid (i.e. a discount off the customer's usage component or total bill) can differ across retailers; and
    - the period over which the discount is available can differ across products and across retailers (i.e. a fixed benefit period or over the entire term of the contract).
  - *Rebates* – Interviewees noted that rebates are not as common as percentage discounts, but where they are used they tend to be applied to the customer's bill and like percentage discounts, may be paid for a variety of reasons.
- *Non-price inducements* – Interviewees indicated that the types of non-price inducements being offered include:
  - loyalty schemes, such as frequent flyer points and credit card reward points;
  - one-off incentives, such as store vouchers and home energy services;
  - a 'green energy' component; and
  - online portals, which enable customers to access their consumption information and other services.
- *Other terms and conditions* – The terms and conditions that interviewees informed us can differ across retailers include:
  - contract length, with some retailers offering 'no lock-in' contracts and others offering one, two or three year contracts;
  - exit fees, with some retailers charging a fee for terminating a contract early while others do not; and
  - other fees and penalties, with some retailers charging fees and penalties for things like late payment and credit card processing fees, while others do not.

Some electricity retailers also indicated that they offer:

- feed-in products to customers with solar panels; and
- flexible pricing (time of use tariffs) to customers with an interval or smart meter.

Another smaller electricity retailer said it offers customers an 'integrated energy solution', which includes both the supply of electricity, energy efficiency and energy management solutions.

5.1.2 Role of dual fuel and multi-utility products

Of the 15 retailers interviewed, eight currently offer to supply gas and electricity on a dual fuel basis (with an additional discount for acquiring both fuels), and a small number are also bundling electricity and/or gas with other products, like internet and phone services.

When asked about the benefits of offering a dual fuel or multi-utility product, interviewees made the following observations:

- Offering a bundled product provides a retailer with more scope in terms of customer acquisition and can reduce average acquisition costs.
- Selling a bundled product may make customers more 'sticky' (i.e. less likely to switch). The term 'may' has been used in this context because while the majority of interviewees thought that selling two or more products made customer stickier, two retailers stated that this rule doesn't always hold and it will depend on the value proposition to the customer.
- While providing customers with a single bill was originally viewed as one of the main benefits of dual fuel or multi utility products, interviewees noted that no retailer had gone down this path because the billing cycles for gas and electricity are not aligned. Also, retailers fear that it may cause 'bill shock' and prompt customers to switch.

Interviewees also observed that the importance of offering dual fuel or multi-utility products can differ across jurisdictions. This observation is consistent with the responses that survey participants provided to the following question:

> How would you rate the importance of being able to offer a dual-fuel or multi-utility product in each jurisdiction on a scale of zero to five, where zero means not important and five means very important?

Table 5.1 sets out the median ratings survey participants assigned to each jurisdiction.

Table 5.1: Importance of Dual Fuel or Multi-Utility Products – Median Ratings (0 means not important and 5 means very important)

	ACT	NSW	SE Qld	Regional Qld	SA	Tas	Vic
Rating	3.0	2.5	2.0	n.a.	2.5	0.5	3.0

As Table 5.1 indicates, the ability to offer a dual-fuel or a multi-utility product is perceived to be moderately important in Victoria and the ACT and of less importance in SA, NSW and SE Queensland and Tasmania. The higher ratings accorded to Victoria and the ACT in this context are not surprising given:

- the penetration of gas is much higher in Victoria than it is in other states (see Table 3.3 and Table 3.14); and
- the penetration of gas in the ACT is also relatively high and customers in the ACT are accustomed to purchasing gas and electricity on a bundled basis.

The importance of being able to offer both gas and electricity in Victoria attracted considerable attention in the interviews, with some smaller retailers noting that while a new entrant retailer can commence by offering electricity alone in this market, if they want to expand beyond a particular threshold they need to offer both. According to one retailer, that threshold is around 300,000-400,000 customers.

One smaller retailer that has entered the Victorian gas retail market noted that as soon as it started to offer dual fuel, its customer numbers increased. Two other electricity retailers that are in the process of entering this market informed us that they anticipated a similar phenomenon.

5.1.3 Influence of customer preferences

On the issue of customer preferences, interviewees' responses were quite mixed, with some stating that customer preferences have a significant influence on retailer product offerings, while others stated they have little influence.

Those retailers that claimed customer preferences have a significant influence, pointed to the development of the following products in support of their view:

- 'no lock-in' contracts and no exit fee products;
- products that enable customers to manage their bills (e.g. My AGL Monthly Bill and Origin's EasiPay);
- Aurora's pre-payment electricity product;
- Powershop's Powerpack electricity product; and
- EnergyAustralia and Origin Energy's fixed price gas and electricity products.

Some of these retailers also informed us they use focus groups and test the market before introducing new products.

Of the retailers that said customer preferences have little influence on their products, one said it is difficult to identify precisely what customers want because it is a low involvement product. Another said that continuous changes to the regulatory framework meant that retailers have become 'more regulatory driven than customer driven'.

5.2 Product differentiation and innovation

The manner in which gas and electricity retailers compete will depend, amongst other things, on the extent to which they can differentiate their products from those offered by other retailers. Interviewees were therefore asked to explain:

- how retailers try to distinguish their products and brand from those offered by other retailers; and
- the extent to which there has been any product differentiation and innovation in gas and electricity retail markets across the NEM.

Survey participants were also asked to rate the degree of product differentiation and innovation across jurisdictions.

The responses to these questions are outlined below.

5.2.1 Measures used by retailers to differentiate their products

While gas and electricity are relatively homogenous products, interviewees informed us that retailers employ a range of measures to try and distinguish their products and brand from other retailers, including:

- offering one simple product;
- offering a range of 'tailored' products, with different contract lengths, fixed benefit periods and combinations of price and non-price inducements;
- offering 'no lock-in' contracts and/or waiving exit fees;
- offering higher quality customer service (e.g. first call resolution, online self-service, dedicated account managers and/or a personalised service);
- empowering customers by providing them with more accessible information about their energy use and bills;
- being involved in the community (e.g. through the sponsorship of sporting teams or community events or being the host retailer);
- being affiliated with other loyalty schemes (e.g. frequent flyer and credit card reward schemes);
- green credentials (e.g. being owned by a renewable generator);
- offering an online service only;
- offering a dual-fuel or multi-utility product; and
- allowing customers to purchase electricity in advance and other non-traditional ways (e.g. internet only retailing).

One interesting point that emerged from this discussion is that, with one or two exceptions, smaller retailers tend to offer only a single 'best offer' product, whereas larger retailers (including larger second tier retailers) offer a number of different products, with varying contract lengths, fixed benefit periods and gradations of price and non-price inducements.

When asked about this difference in approach, smaller retailers stated that they are trying to appeal to customers' desire for simplicity and that it can be costly and complex to offer more products. Larger retailers, on the other hand, stated they are offering more 'tailored' products to meet the diverse needs of different customer types. Some interviewees also observed that larger retailers are in a better position to offer a range of products, because they have more sophisticated billing systems.

The rationale for offering more than one product was explained by one larger retailer as follows:

> *'The rationale is targeting customer segments based on the lowest offer they will accept. There are a range of channels out there, so when we are proactively approaching customers [through one of these channels] we may offer something other than our best offer, but when customers come directly to us they can access our lowest offer from our website.'*

Other smaller retailers offered the following perspectives about the approach employed by larger retailers:

> *'Larger retailers are using a scattergun approach to appeal to customers.'*

> *'The objective seems to be to confuse customers.'*

> *'These retailers are running a confusion campaign.'*

Another interesting trend that some interviewees identified was for smaller retailers to offer 'no lock-in' contracts or to waive exit fees. This form of product differentiation was viewed as being of particular importance to new entrants that are trying to encourage customers to switch, as reflected in the following statement from a smaller retailer:

> *'We decided to offer 'no lock-in' contracts because it was an easier proposition for new customers to try a new retailer. Offering this type of contract provided a marketing opportunity to build brand awareness and also gave customers more confidence that they wouldn't be held captive if they decided to try us out.'*

5.2.2 Product differentiation and innovation across jurisdictions

To determine what gas and electricity retailers think about the degree of product differentiation and innovation in the jurisdictions they operate, survey participants were asked:

> How would you rate the degree of product differentiation and innovation in each jurisdiction?

The responses to this survey question revealed that the degree of product differentiation and innovation in both gas and electricity retail markets is perceived to be highest in Victoria, followed in declining order by SA, the ACT, SE Queensland, NSW, Tasmania and regional Queensland.

Further detail on the views expressed by interviewees about the degree of product innovation in electricity and gas retail markets is set out below.

Product innovation in electricity retail markets

During the interviews, participants were asked to explain why the degree of product innovation differs across jurisdictions. Most interviewees responded that there has been limited innovation to date and that, with the exception of smart meter and pre-payment meter enabled products, retail products tend to be the same across jurisdictions.

When asked why Victoria was assigned a higher rating than other jurisdictions, interviewees noted that there had been some examples of retailers offering alternative tariff structures. They also noted that the removal of RPR, coupled with the mandated roll out of smart meters, has paved the way for the introduction of more innovative products, such as flexible pricing (time of use pricing), Dodo's Free Hour of Power[36] product and Powershop's Powerpacks.[37] However, interviewees noted that regulatory constraints on flexible pricing in Victoria and the poor quality of some smart meter data[38] were acting as a constraint on innovation in Victoria and limiting the types of products retailers can offer.

Other impediments to innovation that were identified by interviewees include:

- metering infrastructure outside Victoria;
- the tariff structures adopted by distribution networks;
- RPR in those jurisdictions where it is still applied because retailers 'can't guarantee that they will be able to recover the capital invested in innovation';
- other regulatory requirements that restrict a retailer's ability to offer innovative products (e.g. product disclosure requirements, restrictions on the form of contracts, restrictions on billing frequency and the information to be provided to customers on bills); and
- low levels of customer interest.

Looking forward, interviewees expect the roll out of smart meters in other jurisdictions and changes in technology to pave the way for further innovation, although they cautioned that unnecessary regulation could prevent customers from benefiting from this innovation.

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36 This product, which is only available in Victoria, provides customers with a free hour of power between 6 and 7 am every day.

37 Powershop's customers can either have Powershop purchase electricity for them or purchase electricity from Powershop's online shop in 'packs' of varying sizes and costs. The four types of packs that Powershop is currently offering include:

- Special Packs, which are discounted packs that are offered at various times.
- Future Packs, which enable customers to buy electricity for coming months and, in doing so, spread the costs over the year.
- Green Packs, which support renewable energy.
- Top-up Packs, which can be used at any time

38 Interviewees informed us that smart meter data can be missing opening reads, closing reads and half hourly reads.

Product innovation in gas retail markets

In response to the same set of questions for gas retail markets, interviewees noted there has been far less innovation in gas than in electricity. This difference was attributed to the continued use of accumulation meters and the relatively low level of interest that small customers purportedly have in gas (see section 7.1).

While most interviewees did not expect any real product innovation to occur in gas retail markets over the next five years, one retailer indicated it was looking into installing smart gas meters.

5.3 Marketing

Marketing is generally undertaken by retailers to advertise specific offers, or to build up brand awareness. In markets characterised by a relatively low degree of customer engagement, marketing can also play an important role in educating customers about the choices they have, reducing search costs and prompting customers to switch.

To get a better understanding of how gas and electricity retailers market their products and the implications this may have for rivalry and the level of customer engagement, interviewees were asked to provide an overview of the marketing strategies retailers employ. In doing so, interviewees were asked to:

- state whether there are any types of customers that retailers target, or that have less access to competitive offers; and
- identify the marketing channels that retailers currently use and the channels that are likely to become more important in the future.

Interviewees that retail both gas and electricity were also asked whether they market gas separately or as part of a dual-fuel or multi-utility product offering.

A separate question was also included in the survey, which asked retailers to indicate the range within which their average customer acquisition costs lie.

An overview of the responses received to each of these questions is provided below.

5.3.1 Target customers

Of the 15 retailers that were interviewed and surveyed, two target small business customers, one targets residential customers and the remainder target both residential and small business customers.

When asked if there are any particular groups of residential or small business customers that retailers try to target, interviewees noted that it can be difficult to target customers in the mass market segment. Most retailers did note though that ideally they would only take on credit worthy customers that pay on time. However, there are costs associated with running credit checks, so this type of segmentation is not widespread. A number of host retailers also informed us they are unable to reject hardship customers, or customers with a poor credit history.

In terms of customer access to competitive offers, the overwhelming response from interviewees was that all customers have the same level of access to competitive offers. It was acknowledged though that the ability of some groups (e.g. customers with special needs, non-English speaking customers and the elderly) to take advantage of these competitive offers may be constrained because their level of understanding may be impaired. One retailer also observed that, from a consumer protection perspective, retailers may be more cautious about approaching these types of customers.

5.3.2 Marketing channels

During the interviews, retailers informed us that marketing can occur through a variety of channels, which either target particular customer segments or the broader market. The types of marketing channels that retailers identified include:

- direct forms of contact, such as door knocking, outbound telemarketing, direct mail and kiosks in shopping centres for new customers. For existing customers, retailers utilise digital forms of contact and bill inserts for existing customers;
- online channels, such as a retailer's website, search engine optimisation, social media and third party comparator sites;
- mass media and outdoor media, such as TV, radio, print, billboards and advertising on public transport; and
- other channels, such as moving home aggregator services, retailer shop fronts, relationships with affiliates (e.g. sellers of solar panels or appliance retailers) and team or community sponsorship.

Retailers also informed us that the cost and effectiveness of these channels can vary widely and that there is no single marketing channel that delivers everything they require. Hence, retailers tend to use a variety of channels.

Elaborating further on this point, one interviewee stated that most retailers have a channel optimisation strategy. However, a number of retailers made it clear they are yet to find the optimal mix of channels, and that the decision to use particular channels is becoming more compliance driven. As one larger retailer explained:

> *'There may well be an optimal mix but we haven't found it yet. It's actually largely compliance based. Whatever is giving us grief, we ditch.'*

Another interesting point raised by a larger retailer is that some of the channels listed above target different types of customers. For example:

- customers that use aggregator services like On the Move, tend to focus on the convenience of having multiple utilities connected when they move (e.g. electricity, gas, water, phone, broadband and/or pay TV) rather than price; whereas
- comparator sites tend to be used by customers who are looking for the best deal.

This retailer went on to explain that being able to segment prospective customers in this manner enabled retailers with numerous products to market these through different channels.

Some other interesting points made about marketing channels are set out below.

Door knocking

The topic of door knocking was raised in a number of interviews. We were informed that while AGL, Origin and EnergyAustralia no longer use this channel, a number of other retailers continue to do so. Those retailers interviewed that are still using this channel said they think door knocking is an important marketing channel, particularly for small business customers, who retailers claim prefer a face-to-face experience.

One smaller retailer that does not engage in door knocking said it still benefits from door knocking by other retailers, because some customers that are approached undertake their own research to find the best deal.

Comparator sites

Third party comparator sites also attracted quite a bit of attention, with at least three retailers expressing some concern about the potential for the rankings on *some* comparator sites to be distorted by the commissions received from particular retailers, or from sales of particular products (e.g. dual-fuel or single fuel).[39] Two other retailers considered that while this is not necessarily an issue, they closely monitor comparator sites to ensure that their products are appropriately ranked.

While concerns were raised about third party comparator sites, the AER's Energy Made Easy site and other government sponsored sites were viewed favourably by retailers. However, a number of retailers asserted that the Victorian Government's new Switch On site is 'too complex' for customers.

Marketing channels in the future

Looking forward, interviewees expect:

- online marketing channels, such as third party comparator sites and social media, to become more prominent; and
- some direct forms of contact channels, such as outbound telemarketing, to decline in importance, because as one retailer stated, 'customers don't want to engage in this way'.

[39] As one retailer explained, if a higher commission is paid for customers that sign up to the same retailer for gas and electricity than the commission paid for a customer that signs up to electricity only, then the comparator site may have an incentive to steer customers to the dual fuel product.

One interviewee also noted that retailers need to find the right balance between face-to-face and other forms of marketing, because if customers feel they have no relationship with the retailer then their loyalty will diminish.

Another interesting marketing development that one retailer identified was a push to develop a more community-based marketing channel for rural and regional areas.

5.3.3 Marketing by gas retailers

Of the eight gas retailers that were interviewed, only one currently markets gas as a separate product. The other seven retailers informed us that while they may have gas only customers, they only market gas as part of either a dual-fuel or multi-utility offering.[40]

5.3.4 Customer acquisition costs

As part of the survey, gas and electricity retailers were asked to specify the range that their average gas and electricity customer acquisition costs fall into within each jurisdiction (e.g. $0-$50, $51-$100, $101-$150, $151-$200). Of the nine electricity retailers that responded to this survey question:

- one indicated that it does not spend anything on customer acquisition;
- three indicated their costs fall into the $51-$100 range across all active jurisdictions;
- three indicated their costs fall into the $101-$150 range across all active jurisdictions; and
- two indicated their costs fall into the $151-$200 range across all active jurisdictions.

Across the last three categories, there was a mix of host and second tier retailers. There does not appear therefore to be a clear relationship between the type of retailer and the average cost of acquiring customers.

Four gas retailers also responded to this survey question. With the exception of one retailer, which indicated that its gas acquisition costs fall into the $0-$50 range, the ranges were identical to those identified by the retailer for electricity. This is not really surprising though, given gas tends to be marketed through a dual fuel or multi-utility offering.

Another interesting observation made by some retailers is that customer acquisition costs tend to depend more on the channel used to acquire the customer and the type of product sold (e.g. single fuel or dual-fuel), rather than the jurisdiction in which the customer is located. One second tier retailer did note though that customer acquisition costs tend to be higher in smaller jurisdictions, while another stated that differences in the level of customer awareness across jurisdictions and the retention strategies employed by more established retailers, can give rise to different costs across jurisdictions.

40 That is not to say these seven retailers won't sell gas as a separate product. It is just that they don't *market* gas as a separate product.

5.4 Retention strategies

Retention strategies are generally used by retailers to limit the number of customers that switch to another retailer and can take a variety of price and non-price forms. To better understand how gas and electricity retailers try to retain customers and the effects on rivalry and the level of customer engagement, interviewees were asked to:

- provide an overview of the retention strategies that retailers employ;
- identify whether particular customers are targeted by retailers using these strategies; and
- evaluate the effectiveness of these strategies.

The first point that a number of second tier retailers made about this issue is that their focus to date has been on acquiring new customers, not on retaining customers. By their own admission, the retention strategies employed by recent entrants have tended to be 'less sophisticated' than those used by host retailers and more established second tier retailers. However, as one retailer pointed out, if a smaller retailer is offering a no lock-in contract, then it 'creates the need to have high level of customer satisfaction, service and to offer the best prices at all times', because its customers have already demonstrated a willingness to switch. The need for these retailers to have recourse to other retention strategies may therefore be lower than it is for other retailers.

The retention strategies that interviewees told us are being used, to varying extents, by host and larger second tier retailers include:

- Customer service-related activities (e.g. first call resolution and online self-service), which are designed to minimise the interaction customers need to have with the retailer.
- Cross selling (e.g. selling gas and electricity on a dual fuel basis or engaging in other forms of bundling) and value adding (e.g. offering an energy efficiency service), both of which are designed to make customers more 'sticky' (see section 5.1.2).
- Measures that are designed to minimise the incidence of 'bill shock' (e.g. monthly billing and smoothed payment plans), which retailers claim is one of the leading causes of customer switching (see section 7.2).
- Reward schemes (e.g. frequent flyer points, credit card reward points and targeted rewards[41] campaigns), which are designed to make customers more 'sticky' and engender loyalty toward the retailers.
- Offering customers that are nearing the end of their fixed benefit period or fixed term contract a new competitive product offering.
- Contacting customers that have indicated they intend to switch (either directly or through a Business-to-Business (B2B) notification) and offering them a higher discount to stay ('save calls').

41 The example cited by one of the retailers is providing a targeted set of valuable customers a free energy monitor.

In effect, the first four of these techniques are designed to minimise the incidence of customers that *consider* switching, while the last two are designed to reduce the actual level of switching.

As to whether there are any particular customers that retailers target with these strategies, interviewees said that discretionary strategies, such as save calls and targeted reward campaigns, tend only to be applied to customers that are considered 'valuable' (e.g. they have a good credit history, pay their bills on time and/or are large customers).

In general, retailers believed that these strategies have been effective and that a greater degree of competition is now occurring around retention. A number of interviewees also noted that going forward larger retailers are likely to place greater emphasis on these types of strategies as a means of trying to reduce the cost of customer churn. As one smaller retailer explained:

> *'…the biggest killer for the big three retailers is the cost of churn, which is very high. For example, you win 100,000 customers and lose 80,000 customers so the cost can be very high to acquire just 20,000 customers.'*

6. Retailer Rivalry

Independent rivalry is an integral element[42] of an effectively competitive market and is one of the six criteria the AEMC is required to consider when assessing the state of retail competition across and within the NEM jurisdictions.

To help inform the AEMC's assessment of the degree of rivalry currently prevailing in gas and electricity retail markets, interview participants were asked to:

- explain how gas and electricity retailers currently compete to attract and/or retain residential and small business customers and, in particular, whether they are engaging in:
  - price rivalry (e.g. offering discounts, rebates or alternative tariff structures); and/or
  - non-price rivalry (e.g. product differentiation, customer service activities, non-price inducements, bundling products and offering different terms and conditions);
- identify the factors that are likely to affect rivalry in a jurisdiction; and
- state whether there has been any change in rivalry over the last two years.

Survey participants were also asked to:

- rate the degree of rivalry in gas and electricity retail markets in each jurisdiction; and
- state whether there is a difference in the level of rivalry in urban and rural/regional areas.

The box below contains a summary of the responses received on each of these issues.

Summary: Retailer perceptions on rivalry

How retailers compete

Electricity and gas retailers primarily compete on the basis of price (predominantly the percentage discount method) to attract and retain residential and small business customers.

Factors affecting rivalry in a particular jurisdiction

The factors that retailers noted could affect rivalry in a particular jurisdiction include:

- the number and type of competing retailers;
- the attractiveness of the market to retailers, which will depend on the size, geographic dispersion and nature of customer base, customer engagement, whether RPR is applied and the degree of regulatory and political risk; and
- the ease with which entry and/or expansion can occur, which will primarily depend on how RPR is applied in those jurisdictions where it still applies and wholesale market conditions.

Current degree of rivalry

Electricity: Rivalry perceived as highest in Victoria, followed by SA, NSW and SE Queensland, and the ACT.

Gas: Rivalry perceived as highest in Victoria, followed by NSW, SA, SE Queensland, ACT, regional Queensland and Tasmania.

Differences in rivalry in urban vs rural/regional areas

Electricity: Three survey participants noted a difference in the degree of rivalry in urban and rural/regional areas and attributed this to brand loyalty, higher customer acquisition costs and the small size of the market.

Gas: Five survey participants noted a difference in the degree of rivalry in urban and rural/regional areas and attributed this to contractual or physical constraints on some regional pipelines, the size of these markets, brand loyalty and higher customer acquisition costs.

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42 In principle, independent rivalry should provide retailers with an ongoing incentive to:
- supply products that are most valued by consumers at prices that over the longer run reflect the efficient cost of supply (allocative efficiency);
- reduce the cost of supply by seeking out productive efficiencies; and
- adapt over time to changes in consumer preferences and/or technology, by implementing measures that reduce costs, improve quality and/or result in new product developments (dynamic efficiency).

The remainder of this chapter provides further detail on the views expressed by interview and survey participants on rivalry in electricity and gas retail markets across the NEM.

6.1 Electricity retail markets

6.1.1 Form of rivalry employed by electricity retailers

The first set of questions that interviewees were asked to address on rivalry, were designed to get a better understanding of:

- how electricity retailers compete to attract customers;
- retailers' perceptions of the importance of non-price forms of rivalry; and
- the influence that retention strategies are having on the degree of rivalry.

How electricity retailers compete

Interviewees responded to the first question by stating that while electricity retailers employ a variety of techniques to try and distinguish their products (see section 5.2.1), they predominantly compete on the basis of price and, in doing so, have tended to rely on the percentage discount method (see section 8.1).

The emphasis retailers have placed on price-based competition is not surprising given that electricity is a relatively homogenous product and there has been limited product differentiation to date (see section 5.2). As one interviewee explained:

> *'Electricity is a low involvement and relatively homogenous product, so price has been the key point of distinction between retailers.'*

Customer preferences also appear to have played a role in the dominance of this form of rivalry, with one retailer noting that customers will only switch in response to a 'substantial' discount and another two stating the discount has to be over 10% to prompt a customer to switch.

Little was said by most interviewees about whether the reliance placed on percentage discounting is likely to change over the next five years. However, one interviewee suggested that other non-price forms of rivalry, like customer service and bundling, were likely to become more important in the future. Another noted that some comparator sites are now trying to capture the effects of other 'value adds', and that while the emphasis customers currently place on price was unlikely to change overnight, this development could prompt change in the future.

Importance of non-price forms of rivalry

When asked about the importance of non-price forms of rivalry, interviewees made the following observations:

- *Product differentiation* – A number of interviewees observed that electricity is a relatively homogenous product and while retailers try to distinguish their products on the basis of price, contract terms and conditions, and price and non-price inducements, there is little competition occurring beyond that.
- *Customer service* – There were mixed views expressed about the importance of customer service as a means of attracting customers, but it was seen as an important way of trying to retain existing customers. A number of retailers also noted that customer service tends to be valued more highly by small businesses than residential customers, and that some retailers had responded to this by developing a premium small business service.
- *Brand loyalty* – Some retailers informed us that in smaller jurisdictions (e.g. the ACT and Tasmania), rural and regional areas, brand loyalty and community presence can be far more important than price, because customers in these areas want to feel they are dealing with someone in the community. Activities directed toward establishing a local presence (e.g. sponsoring a local sporting team or community event) can therefore be a more important form of rivalry in these areas than price discounting.
- *Loyalty schemes* – Frequent flyer points, credit card reward points and other loyalty based rewards, were viewed by a number of retailers as an important way to attract and retain customers. However, such schemes were generally viewed as being of secondary importance to price.
- *Green energy products* – Although offering a 'green energy' product was once viewed as an important way of attracting customers, interviewees considered that its importance has diminished following the introduction of the Carbon Tax, with a number of interviewees observing customer 'green fatigue'. Interviewees were unclear whether the removal of the Carbon Tax will prompt a resurgence in demand, but many surmised that demand was unlikely to return to its original level because a large number of green energy customers have now installed their own solar panels.
- *Bundling* – Offering electricity as part of a dual fuel or multi-utility offering[43] was seen by most interviewees as an important way of competing to attract and retain customers in Victoria and the ACT (see section 5.1.2); but less important in other jurisdictions.
- *Contract terms and conditions* – A number of second and smaller retailers observed that there is some degree of competition now occurring around key contract terms, like exit fees and other penalties, with a number of small and larger retailers having now moved away from imposing these types of charges.

Influence of retention strategies

In the course of discussing the retention strategies employed by host retailers and more established second tier retailers (see section 5.4), the following observations were made by interviewees about the influence that retention related activities are having on competition:

[43] For example, bundling electricity, gas and internet services.

- A greater degree of competition is now occurring around retention.
- Some retailers are engaging in 'aggressive' and potentially 'misleading' retention activities, particularly when trying to win back a customer who has decided to switch.
- To the extent that retention strategies result in customers that would otherwise have left remaining with the retailer, switching rates will understate the actual level of competition. According to some, this effect is 'potentially huge'.

6.1.2 Rivalry across the jurisdictions

To elicit retailers' views on the degree of rivalry in each jurisdiction, interview and survey participants were asked the following question:

> How would you rate the overall degree of rivalry amongst electricity retailers in each jurisdiction, on a scale of zero to five, where zero means no rivalry and five means highly competitive?

Table 6.1 sets out the median ratings that survey participants assigned to each jurisdiction.

Table 6.1: Degree of Rivalry – Electricity Retail Markets – Median Ratings
(0 means no rivalry and 5 means highly competitive)

	ACT	NSW	SE Qld	Regional Qld	SA	Tas	Vic
Rating	2	3	3	n.a.	4	n.a.	5

As the results in this table reveal, the degree of rivalry is considered to be highest in Victoria, followed in declining order by SA, NSW and SE Queensland and the ACT. In the course of discussing these ratings, interviewees were also asked to explain:

- whether the degree of rivalry has changed in any jurisdiction over the last two years; and
- the factors that have affected rivalry in each jurisdiction.

The views expressed by interview and survey participants about these two issues are summarised in the jurisdictional tables in Chapter 3.

6.1.3 Rivalry in urban vs rural and regional areas

The final question on rivalry that survey participants were asked was whether there is any difference between the degree of rivalry in urban and rural/regional areas. While the majority stated there is no difference,[44] three survey participants stated there can be a difference because the following factors can deter some entry into rural and regional areas:

- brand loyalty and the value customers in these place on dealing with a retailer that has a community presence;
- higher customer acquisition costs in rural and regional areas; and
- the relatively small size and geographic dispersion of the customer base in these areas.

[44] Interestingly, one of the participants that stated there was no difference in the survey, stated during the interview that customers in rural and regional areas can be underserved by retailers.

6.2 Gas retail markets

6.2.1 Form of rivalry employed by gas retailers

The eight retailers in the sample that are currently supplying gas to residential or small business customers were asked to explain how they compete to attract and/or retain small customers.

These retailers observed that because gas customers are even less engaged than electricity customers and there is no real scope to differentiate their products, gas retailers have tended just to compete on the basis of price (using the percentage discount method), with most of the competition between gas retailers occurring through dual fuel or multi-utility offers.

6.2.2 Rivalry across the jurisdictions

In a similar manner to electricity retailers, survey and interviewees with an interest in gas retailing were asked the following question:

> How would you rate the overall degree of rivalry amongst gas retailers in each jurisdiction, on a scale of zero to five, where zero means no rivalry and five means highly competitive?

Table 6.2 sets out the median ratings that survey participants assigned to each jurisdiction.

Table 6.2: Degree of Rivalry – Gas Retail Markets – Median Ratings
(0 means no rivalry and 5 means highly competitive)

	ACT	NSW	SE Qld	Regional Qld	SA	Tas	Vic
Rating	2	4	2.5		3	1	5

As the results in this table reveal, the degree of rivalry is considered to be highest in Victoria, followed in declining order by NSW, SA, SE Queensland, the ACT and Tasmania. In the course of discussing these ratings, interviewees were also asked whether there are any specific factors that have affected rivalry in each jurisdiction. The responses provided by interviewees are set out in the jurisdictional tables in Chapter 3.

6.2.3 Difference in the degree of rivalry in gas vs electricity retail markets

In a number of interviews, we were informed that the degree of rivalry in gas retail markets is much lower than it is in electricity. When asked why this was the case, interviewees noted the following:

- Small gas customers are less engaged than small electricity customers.
- There are only a small number of second tier gas retailers, particularly outside the Victorian DWGM.

Elaborating further on the latter point, one smaller interviewee noted that unlike the NEM, the design of the various retail gas markets in eastern Australia is 'needlessly complicated' and discourages second tiers from entering this market (see section 4.2).

6.2.4 Rivalry in urban vs rural and regional areas

The final question on rivalry that gas survey participants were asked is whether there is any difference in the degree of rivalry in retail gas markets located in urban versus rural and regional areas.

Of the seven survey participants that responded to this question, five stated that the degree of rivalry can be lower in rural and regional areas of NSW, Queensland, SA and Victoria in areas outside the DWGM. In doing so, they noted that there can be some significant impediments to entry and expansion in rural and regional areas, including:

- the existing contractual commitments on some pipelines, with some pipelines in rural and regional areas reportedly being fully contracted by either a single retailer or a very small number of retailers;
- the limited coverage of pipeline distribution networks in rural and regional areas; and
- the high fixed costs associated with supplying gas to rural and regional areas.

One retailer also noted that brand loyalty, high customer acquisition costs and the small number of customers in these areas, can deter retailers from engaging in the same degree of rivalry in rural and regional areas.

7. Customer Engagement

In an effectively competitive market, customers play an important role in constraining the behaviour of retailers, by switching to another retailer (or another product offered by the same retailer)[45] in response to any deterioration in the price and/or quality of a product. While not all customers need to switch to impose a competitive discipline on retailers, a sufficient number need to be willing to do so. This, in turn, requires customers to be:

- aware of their ability to switch;
- able to make an informed decision about the options available to them; and
- able to readily switch between retailers (or products).

To help inform the AEMC's assessment of these issues and its broader assessment of the exercise of customer choice and customer switching criteria, interview and survey participants were asked to provide their opinion on:

- the level of awareness that small gas and electricity customers have of their ability to switch in each jurisdiction;
- the factors that prompt small gas and electricity customers to switch;
- the extent to which there are any impediments to customers switching; and
- the level of switching by small gas and electricity customers in each jurisdiction.

The box below contains a summary of the responses received on each of these issues.

Summary: Retailers' perspectives on customer engagement

Customer awareness

The level of awareness amongst gas and electricity customers is perceived to be highest in Victoria, followed by SA, NSW, SE Queensland, the ACT, Tasmania and regional Queensland. The difference across jurisdictions has been attributed to the different points each jurisdiction is in terms of FRC, privatisation and deregulation.

Improvements in the level of awareness are expected to occur as competition evolves and through media focus on electricity or gas prices. However, retailers noted an educational campaign may be required in Queensland if RPR is removed. A targeted campaign was also suggested to educate customers on standing offers.

Factors that prompt customers to switch

In retailers' view, small electricity customers are prompted to switch by bill shock, rising prices and/or a direct approach. Once they have decided to switch, customers' selection of a new retailer (or product) will usually depend on price, although for some customers it may depend on things like brand recognition, convenience or customer service.

The same factors influence gas customers to switch, but a significant amount of gas switching is also related to electricity switching.

Impediments to switching

Retailers noted that impediments to switching include: limited customer awareness and interest; complexity of contracts; misconceptions about the governments' role and the protections afforded by standing contracts; exit fees; and the time taken to transfer.

Level of switching

The level of switching by gas and electricity customers is perceived to be highest in Victoria, followed by SA, NSW and SE Queensland, the ACT, Tasmania and regional Queensland.

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[45] For example, switching from a standing offer to a market offer with the same retailer, or switching between market offers with the same retailer.

The remainder of this chapter provides further detail on the views expressed by interview and survey participants about customer awareness and switching.

7.1 Customer awareness

To elicit retailers' views on the level of customer awareness in each jurisdiction, survey participants were asked:

> How would you rate the level of awareness amongst customers of their ability to switch in each jurisdiction on a scale of zero to five, where zero means non-existent, three means moderate and five means very high?

Table 7.1 sets out the median ratings that survey participants assigned to each jurisdiction for both gas and electricity customers.

Table 7.1: Level of Customer Awareness – Median Ratings
(0 means non-existent, 3 means moderate and 5 means very high)

	ACT	NSW	SE Qld	Regional Qld	SA	Tas	Vic
Electricity	2	4	3	n.a.	5	0*	5
Gas	2	3	3	0	4	2	5

* This median rating applies to small non-contestable customers consuming less than 50 MWh. For small contestable customers (i.e. consuming more than 50 MWh), the level of awareness was rated 3.

As the ratings in this table indicate, the level of awareness amongst small gas customers is considered broadly similar to small electricity customers, albeit a little lower in some jurisdictions (i.e. NSW and SA). Across the jurisdictions, the level of awareness amongst both gas and electricity customers is perceived to be highest in Victoria, followed in declining order by SA, NSW, SE Queensland, the ACT, Tasmania and regional Queensland.

Some interviewees linked different levels of customer awareness across jurisdictions with the state and time elapsed in each individual jurisdiction's journey towards FRC, privatisation of government owned retailers and retail price deregulation. These perspectives are reflected in the following two statements:

> *'The customer's mind set differs because of the historic development of the sector. Kennet started privatising in Victoria around 1995, so there is a history for Victorian customers of:*
>
> > *'well the government doesn't own and run the energy sector anymore, so if I want to get a good deal I have to do something about it because the government is not setting the price'.*
>
> *Whereas customers in some other states are at the other end of that scale:*
>
> > *'I don't need to do anything; the government owns it all and sets the price'.*
>
> *This is just a historical mind set, which will improve in other jurisdictions over time.'*
>
> *'The longer the state has been fully contestable, the more customers you get over the line in terms of understanding the choice they have available.'*

Table 7.2 summarises other observations interviewees made about the level of customer awareness in each jurisdiction.

Table 7.2: Retailers' Views on Customer Awareness Across the Jurisdictions

Jurisdiction	Survey Ratings	Interviewee Comments
ACT	**Electricity:** Median: 2 **Gas:** Median: 2	Conflicting views were expressed by the three interviewees that commented on the level of customer awareness in the ACT, with two interviewees claiming it is limited, while another claimed it is relatively high. The last interviewee submitted that regular surveys undertaken in the ACT confirmed customers' awareness of their ability to switch and added that a number of factors had contributed to this awareness, including the One Big Switch campaign. The same interviewee stated that brand loyalty should not be confused with limited customer awareness, because it can also be an indicator of customer satisfaction.
NSW	**Electricity:** Median: 4 **Gas:** Median: 3	There were mixed views about the level of customer awareness in NSW, with four interviewees stating that NSW customers are 'not particularly aware' of their ability to switch, while others asserted that there is a reasonable level of awareness and customers are becoming more engaged. One specific issue that three interviewees claim is affecting customer awareness in NSW is the 'misconception amongst customers that if they are located in a particular distribution network, they can only purchase electricity from the host retailer in that network'. According to these interviewees this misconception is 'further entrenching the dominance of Origin and EnergyAustralia'. These interviewees therefore suggested that further steps be taken in terms of customer education to dispel this misconception.
SE Queensland	**Electricity:** Median: 3 **Gas:** Median: 3	In a similar manner to NSW, mixed views were expressed about the level of customer awareness in SE Queensland. Those interviewees that claimed the level of awareness is relatively low attributed this to the Queensland Government's 2012-13 price freeze and the reduction in the level of marketing activity that followed this event. Other interviewees stated that while these factors have affected the level of switching, they have not affected customers' awareness of their ability to switch.
Regional Queensland	**Electricity:** n.a. **Gas:** Median: 0	No specific comments were made by interviewees about the level of customer awareness in regional Queensland. However, the survey ratings suggest it is non-existent amongst small gas customers and the same observation probably holds for small electricity customers given there is currently only one retailer supplying this area.
SA	**Electricity:** Median: 5 **Gas:** Median: 4	Only three interviewees commented on the level of customer awareness in SA. In short, they are all of the view that customers are 'not particularly aware' of their ability to switch, but provided no explanation for their view. While these views should not be discounted, it is worth noting that five other retailers operating in this state assigned SA a rating of 4 or 5.
Tasmania	**Electricity:** Median: 0 **Gas:** Median: 2	Interviewees considered the level of awareness amongst small electricity customers consuming less than 50 MWh p.a. in Tasmania to be non-existent. However, they expect this to improve once FRC is extended to this group of customers. For gas customers, the level of awareness was considered slightly higher than electricity because gas is a relatively new source of energy in Tasmania and customers have always had the ability to choose between two retailers.
Victoria	**Electricity:** Median: 5 **Gas:** Median: 5	There was broad consensus amongst most interviewees that the level of customer awareness in Victoria is high and that it surpasses all other jurisdictions. A few retailers attributed this level of awareness to the time elapsed since FRC was implemented and retail price deregulation. Another retailer stated that strong consumer advocacy groups in Victoria that are active in the media have also made a significant contribution to the level of awareness in this state. While awareness is considered high in Victoria, two retailers queried why such a large number of customers in Victoria remain on the default standing offer tariff and surmised that despite the best efforts of the Victorian Government, the message just hasn't gotten through to these customers and more needs to be done to address this issue. One of these retailers noted though that there is a lot of apathy amongst customers: *'These people complain about prices increasing but when you tell them they could save at least $150 a quarter by switching, they say 'it's not worth my time'.*

Going forward, interviewees expect the level of customer awareness to increase in most jurisdictions as competition continues to evolve and through media focus on electricity and gas prices. Some interviewees noted though the need for an educational campaign to be conducted by the Queensland Government if it decides to remove RPR, to raise the level of customer awareness in SE Queensland. Interviewees also suggested that targeted education campaigns be carried out to:

- inform customers in NSW that their choice of retailer is *not* constrained by the distribution network in which they are located; and
- educate customers on standing contracts and financial assistance[46] providers about the benefits of moving onto a market contract.

While governments are expected to play a key role in these campaigns, some interviewees stated that they wanted to start to play a greater role in educating customers because customers were receiving 'mixed messages from consumer advocacy groups and regulators and are becoming increasingly confused'.

In terms of differences in the level of customer awareness across customer types, three interviewees informed us that small business customers tend to be 'more aware and better educated' than residential customers in those cases where energy accounts for a large portion of their input costs. Where this is not the case, their level of awareness and understanding is broadly the same as residential customers.

One final observation on customer awareness made by a larger retailer is that even if a customer is aware of its ability to switch, this does not necessarily mean the customer understands why they would switch, or that they are in a position to make an informed decision about switching:

> *'Customers' understanding of what different retailers are offering is not always clear. Even in Victoria, I am not sure customers realise that pricing is deregulated. So the ability to switch doesn't always translate into customers understanding why they would switch.'*

7.2 Customer switching

The second set of customer engagement-related questions posed to interview and survey participants were designed to elicit their views on:

- the factors that prompt small electricity and gas customers to switch to either a new retailer or another product offering from the same retailer;
- the extent to which there are any impediments to customers switching and what, if anything, can be done to remove those impediments; and
- the level of switching by small gas and electricity customers in each jurisdiction.

[46] See, T. Nelson and C. Reid, Reconciling energy prices and social policy, Working Paper No. 37 – Energy and Social Policy, April 2013.

A summary of the views expressed on each of these issues is set out below.

7.2.1 What prompts customers to switch?

According to the retailers we interviewed, residential and small business electricity customers are prompted to switch to another retailer (or another product offered by the same retailer) by:

- bill shock;
- a notification of a substantial price increase;
- a direct approach from a retailer (e.g. door knocking, telemarketing or direct mail); and/or
- media focus on rising electricity or gas prices.

Some interviewees also cited poor customer service and billing practices as a factor that can prompt customers to switch. However, others stated that these factors are unlikely to prompt customers to switch, but they do make customers more amenable to switching if approached by another retailer.

Having made the decision to switch, the retailer (or product) that the customer decides to switch to will depend primarily on price, although as the following retailer pointed out, it will depend on the specific customer's preferences:

> *'For some customers the choice is just about having the service connected by a particular date, so convenience may be more important than price. For customers that want some degree of certainty about the price they will pay for the next couple of years, being able to enter into a fixed price contract may be more important than price. Other groups of customers may just want to be on a standing offer even though it is more expensive than a market offer, because they think it affords them with some degree of 'government protection' in terms of the contractual provisions. So it really comes down to customer preferences.'*

Other factors that interviewees stated could influence a customer's decision include:

- brand recognition;
- convenience; and/or
- customer service, particularly if the customer has previously experienced poor service.

In relation to small gas customers, interviewees stated that while the same factors tend to influence their decisions, a lot of the switching carried out by gas customers is driven by electricity switching. So if a customer decides to switch to another electricity retailer, it will usually switch gas retailers at the same time.

7.2.2 Impediments to switching

Interviewees identified a number of perceived impediments to customer switching, including:

- Some customers' limited awareness of their ability to switch, and low levels of customer interest.
- Factors that affect a customer's ability to make an informed decision, such as:
  - The perceived complexity of contract terms and conditions, prices, discounts, exit fees and other fees and penalties.
  - Misconceptions about the role the government plays in setting retail prices in jurisdictions where RPR has been removed and the risks associated with market offers. As one interviewee pointed out, there are a number of customers that believe if they are on a standing contract they will be afforded government protection.
- Factors that constrain a customer's ability to switch readily between retailers (or products), such as:
  - Fixed term contracts and exit fees. Some smaller retailers noted that while exit fees tend to be relatively low, customers may believe they are a lot higher than what they actually are because of their experience in other markets (e.g. mobile phones). According to these retailers the negative connotations associated with exit fees can impede switching. This point is reflected in the following quote:

    'Even though someone on a fixed term contract may save $500 by switching and their break fee might only be $22, a lot of people still think, "Oh well, I'm stuck on a contract so I can't swap right now".

    I think a lot of that comes down to, for example, mobile phone contracts where you pretty much have to pay out the whole contract because you usually get a handset as part of the contract. While the same principle doesn't apply in energy retailing, I think there's a bit of a lack of understanding on the part of customers about how retail contracts work.'
  - The time it can take for customer transfers to occur once a customer has decided to switch. One retailer claimed that it can be particularly confusing for customers that have decided to leave a retailer to continue to receive bills from that retailer for the next one to two months while the transfer is being affected.

To address these issues, interviewees suggested the following measures:

- *Improved customer education* – To raise customer awareness and dispel some of the misconceptions that customers may have about the role played by government, some interviewees suggested further customer education. However, one retailer noted that 'education of residential customers has to be done in a better way'. Two other interviewees stated that if an educational campaign is undertaken, greater emphasis should be placed on educating customers on standing contracts because:
  - these customers have 'the most to gain by moving to a market contract'; and
  - customers on market contracts have already demonstrated an ability to switch.
- *Better consumer contract regulation* – To reduce some of the perceived complexities of retail contracts, some interviewees suggested further work be carried out to refine the

product disclosure requirements and other regulations so that contracts can be simplified. One interviewee also suggested that if the industry moved toward unit pricing (like supermarkets are now required to) based on an estimated daily usage, it would be easier for customers to compare product offerings and reduce some of the perceived complexity.

- *Industry changes to exit fees* – To ensure that exit fees do not impede switching, some interviewees suggested that the industry as a whole, move away from charging these types of fees. Some smaller retailers informed us that they have already taken steps to remove exit fees. They also noted that a relatively new entrant is offering to pay prospective customers' exit fees to overcome this perceived hurdle.
- *Faster transfer* – One retailer suggested that the transfer should occur within ten days of the cooling off period.

7.2.3 Level of switching across jurisdictions

While specific metrics exist to measure switching by small gas and electricity customers, we saw value in asking retailers about their views on the level of switching across jurisdictions. Survey participants were therefore asked the following question:

> How would you rate the level of switching amongst small customers in each jurisdiction, on a scale of zero to five, where zero means non-existent, three means moderate and five means very high?

Table 7.3 sets out the median ratings survey participants assigned to each jurisdiction for both gas and electricity customers.

Table 7.3: Level of Switching by Small Customers – Median Ratings
(0 means non-existent, 3 means moderate and 5 means very high)

	ACT	NSW	SE Qld	Regional Qld	SA	Tas	Vic
Electricity	1	3	3	n.a.	4.5	n.a.	5
Gas	1	3	3	0	4	1	5

* No ratings assigned to Tasmania or regional Queensland because there is only one retailer currently in these areas.

According to the ratings in this table, the level of switching by small gas customers is broadly similar to the switching undertaken by small electricity customers. This is consistent with the earlier observation that most gas switching occurs as a result of the customer switching its electricity retailer. However, it is worth noting that some interviewees' stated that the level of customer interest and engagement by small gas customers has to date tended to be much lower than it has in electricity. Some retailers noted the potential for this to change in the future, as the effects of the tightening conditions in the wholesale gas market flow through to retail gas prices. The effect that retailers expect this development to have on retail gas markets and small gas customers more generally is considered in further detail in section 9.1.

Across the jurisdictions, the ratings set out in Table 7.3 indicate that the level of switching by gas and electricity customers is perceived to be highest in Victoria, followed by SA, NSW and SE Queensland, the ACT, Tasmania and regional Queensland. Some interviewees observed that the level of switching has dropped in a number of jurisdictions following the decision by Origin, AGL and EnergyAustralia to cease door knocking.

As with customer awareness, interviewees consider Victoria to stand out in terms of customer switching. However, some retailers noted that Victorian customers appear to be becoming disengaged, with the potential for customer fatigue to set in and switching rates to drop. This group of retailers also speculated that switching rates in other jurisdictions, like NSW and SA, could surpass Victoria's as customers in these jurisdictions become more engaged.

In relation to SE Queensland, a large number of interviewees observed that switching rates had fallen considerably following the 2012-13 price freeze and had remained relatively low since because retailers have put little effort into actively marketing in this jurisdiction.

Some other more general comments that interviewees made about switching levels are set out below:

> *'There is more to competitive markets than churn rates and some customers that place greater weight on service will not switch.'*

> *'Switching data will understate the actual level of customer engagement in the market because larger retailers are now placing greater emphasis on retention and these strategies are working.'*

> *'The rates of switching observed in markets like the Victorian retail electricity market are unnaturally high when compared to other industries, like insurance and banking.'*

8. Prices and Profit Margins

In an effectively competitive market, competition can be expected to drive prices down over time[47] to the efficient cost of supply and profit margins down to a level that is commensurate with the risks involved in supplying the product or service. The prices and profit margins prevailing in a market can therefore be important indicators of whether that market is effectively competitive.

To help inform the AEMC's assessment of these indicators, interviewees were asked to:

- explain how gas and electricity retail prices are determined in each jurisdiction; and
- rate the profitability of retailing gas and electricity in each jurisdiction and explain why profit margins differ within and/or across jurisdictions.

Interviewees were also asked separate questions about the retail component (i.e. retail operating costs *plus* retail margin) in Victoria to elicit their views on why it may be higher in Victoria than it is in other jurisdictions. This area of questioning arose out of the finding in the AEMC's 2013 Residential Electricity Price Trends report that the retail component appeared to be higher in Victoria in 2013 than it was in NSW, SA and SE Queensland.[48]

The box below contains a summary of the responses provided to the prices and profit margin questions.

Summary: Retailers' perspectives on prices and profit margins

Prices

Where RPR is still in effect, the regulated price acts as the benchmark for market offers, while in other jurisdictions the retailer's own standing offer price (calculated on a 'cost build up' basis) acts as the benchmark.

The discounts offered by retailers under market offer contracts differ depending on the jurisdiction, customer type, product type (e.g. single fuel or dual fuel) and other conditions, but reportedly have ranged from around 1% to 30% across jurisdictions. Generally, discounts are applied to the energy usage component of a customer's bill, although some retailers apply it to the customer's overall bill, or directly to the market offer price.

Profit margins

Electricity: The profitability of electricity retailing was rated highest in Victoria, followed jointly by SA, NSW and SE Queensland and then Tasmania and the ACT.

Gas: The profitability of gas retailing was rated highest in Tasmania, followed jointly by Victoria, NSW and SA, SE Queensland and the ACT.

According to retailers, the profit margins earned by both gas and electricity retailers can differ depending on the time of year they are measured and can also differ: across retailers (e.g. depending on the retailer's costs); across jurisdictions (e.g. depending on whether RPR applies, the risks of supplying the jurisdiction and competition in the jurisdiction); within jurisdictions (e.g. depending on the distribution network in which customers are located); and across customer types (e.g. depending on the volume of energy consumed and the load profile).

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47 The term 'over time' has been used in this context because in an effectively competitive market there may be points in time where prices deviate from costs. Over time though, effective competition will drive prices (and profit margins) back to efficient levels.

48 AEMC, 2013 Residential Electricity Price Trends, 13 December 2013, pp. iii and xiv.

The remainder of this chapter provides further detail on the views expressed by interview and survey participants about prices and profit margins.

8.1 Prices

To get some insight into how prices are determined in gas and electricity retail markets across the NEM, interviewees were asked to:

- describe how prices under standing offer contracts are determined and what benchmark retailers use when developing market offers in each jurisdiction;
- explain how prices can be varied once a customer has entered into a contract; and
- provide further detail on the discounts offered by gas and electricity retailers and how they are applied.

An overview of the interviewees' responses is set out below.

8.1.1 Standing offer and market offer prices

According to interviewees, the price specified in a *standing offer* contract will be based on either:

- the regulated retail price in those jurisdictions that are still subject to RPR (i.e. SE Queensland, the ACT, Tasmania and NSW[49] for electricity and NSW for gas); or
- the retailer's own estimate of the cost of supply (subject to any cap imposed by a voluntary pricing agreement) in those jurisdictions that are not subject to RPR.

In relation to the prices applicable under *market offers*, interviewees informed us that retailers tend to adopt a benchmark rate for the usage and supply charges and then apply their discounts to the benchmark. In terms of the benchmarks used by retailers, interviewees informed us that:

- the regulated price will *tend* to act as the benchmark in those jurisdictions that are still subject to RPR. We use the word 'tend' in this context because some interviewees identified instances where individual retailers have adopted a higher benchmark price than the regulated price for their market offers; and
- the retailer's own standing offer will act as the benchmark in other jurisdictions.

8.1.2 Variation of prices over the term of a contract

On the issue of price variations, interviewees stated that, with the exception of fixed price contracts, the price payable by a customer can be varied over the term of its standard or market contract to reflect changes in the retailer's costs. The extent to which prices can be varied seems to differ across retailers, with some retailers reportedly only passing through

49 Note that electricity based RPR will be removed in NSW from 1 July 2014. See Barry O'Farrell MP, Media Release: Delivering Lower Electricity Prices for NSW Households, 7 April 2014.

changes in uncontrollable costs,[50] while others pass through changes in both uncontrollable and controllable[51] costs.

In terms of the frequency with which prices can be varied, interviewees informed us that prices are generally varied only once a year in line with changes in network charges and environmental scheme costs, or the regulated price, in those jurisdictions where RPR applies.

Although interviewees considered that the ability to vary prices to reflect changes in the costs of supply was critical from a risk management perspective, three interviewees raised concerns about the potential for some retailers to use this mechanism to raise prices by more than the change in underlying costs and, in so doing, extract a higher margin from affected customers.

8.1.3 Discounts

In relation to the discounts offered by retailers under market offer contracts, interviewees made the following observations:

- Discounts can be offered for a variety of reasons (see section 5.1.1) and may be conditional or unconditional.
- The discounts offered by retailers differ depending on the customer type (i.e. residential or small business customers), product type (e.g. single fuel, dual fuel or multi-utility) and other conditions, but reportedly have ranged from around 1% to 30% across the jurisdictions.
- For simplicity, some retailers offer the same discounts across jurisdictions, while others apply different discounts to reflect the different regulatory and competitive conditions prevailing in that jurisdiction.
- A discount in excess of 10% is required to make customers switch.

When asked what the discounts are applied to, interviewees informed us that it differs across retailers, but in general it will be applied to:

- the energy usage component of a customer's bill;
- the customer's overall bill; or
- the tariffs specified in the market offer.

Of these three alternatives, the energy usage discount is reportedly the most common.

Given the alternative ways in which discounts can be applied, we asked interviewees whether they thought customers understood the different discount structures. The majority stated that while retailers have an obligation to explain how their discounts are applied, most[52]

[50] For example, changes in network tariffs, government taxes, the costs of environmental schemes and inflation.

[51] For example, changes in retail operating costs.

[52] An exception to this that was noted by one interviewee is residential customers with solar panels. This interviewee noted that customers with solar panels tend to be more informed about electricity pricing structures and discount structures than other residential customers.

residential customers *can* find the alternative structures confusing when comparing different offers. In relation to small businesses, the interviewees that specifically target this group of customers told us that small businesses are usually more informed than residential customers and therefore have a better understanding of the alternative structures.

Two other discounting related behaviours that interviewees identified as potentially misleading are:

- Applying the discount to an elevated benchmark rate.
- Using energy usage discounts in rural and regional areas because the daily supply charge in these areas tend to account for a more significant proportion of the customer's bill.

8.2 Profit margins

To determine what gas and electricity retailers think about the profitability of retailing in each of the jurisdictions they operate, survey participants were asked:

> How would you rate the profitability of retailing in each jurisdiction, on a scale of zero to five, where zero means not profitable and five means very profitable?

A number of survey participants elected not to answer this question. Responses to this question were therefore only received from:

- nine out of the 13 electricity survey participants; and
- six out the seven gas survey participants.

Table 8.1 sets out the median ratings that this sub-set of survey participants assigned to each jurisdiction for both gas and electricity.

Table 8.1: Profitability of Retailing – Median Ratings
(0 means not profitable and 5 means very profitable)

	ACT	NSW	SE Qld	Regional Qld	SA	Tas	Vic
Electricity	1	2	2	n.a.	2	1.5	3
Gas	1	2.5	2	n.a.	2.5	3	2.5

As the information in this table reveals, the median ratings ranged from just one to three across all jurisdictions, which implies that, at best, retailers consider retailing to be moderately profitable.

The ratings in Table 8.1 also indicate the following about the profitability of retailing electricity and gas:

- *Electricity* – Victoria is considered by retailers to be the most profitable jurisdiction for electricity retailing, while the ACT is considered least profitable. In between these two extremes, NSW, SE Queensland and South Australia are considered equally profitable while Tasmania is considered marginally more profitable than the ACT.

- *Gas* – The profitability of gas retailing is perceived to be highest in Tasmania and lowest in the ACT. In between these two extremes, Victoria, NSW and SA are considered equally profitable and SE Queensland slightly less profitable.
- *Electricity vs Gas* – While the ratings in Table 8.1 suggest there is a difference between the profitability of retailing gas and electricity, the organisations that participated in both the gas and electricity surveys ascribed the *same* ratings to both energy sources. The difference in the median ratings simply reflects therefore the different composition of the two survey groups. Some care should therefore be taken when comparing the ratings assigned to gas and electricity.

The median ratings in Table 8.1 and observations set out above are broadly consistent with the comments made by interviewees when asked to explain why gas and/or electricity profit margins may differ across or within jurisdictions. An overview of the comments that were made in response to this question is provided below.

8.2.1 Profit margins in electricity retail markets

Interviewees with interests in electricity retailing informed us that the profit margins earned by electricity retailers can differ depending on the time of year they are measured and can also differ in the following ways:

- *Across retailers* – According to interviewees, the margins earned by individual electricity retailers can differ depending on their operating costs and hedging costs.
- *Across jurisdictions* – Interviewees indicated that the margins earned by electricity retailers can differ across jurisdictions depending on:
  - whether retail prices are regulated[53] in that jurisdiction and, if so, how they are regulated (e.g. what allowances are included and how they are determined);
  - whether there are other voluntary pricing arrangements in place in that jurisdiction, which influence the prices retailers charge;[54]
  - the risks associated with supplying that jurisdiction, which can differ depending on the conditions prevailing in the wholesale market, the nature of demand and the extent to which the risks can be hedged; and
  - the level of competition in that jurisdiction.
- *Within a jurisdiction and across customers* – Interviewees stated that the margins earned by electricity retailers can differ within a jurisdiction and across customers depending on:
  - the distribution network in which their customers are located;
  - the type of customers being supplied; and

53 Note that NSW is the only jurisdiction that currently regulates retail gas prices for small customers.

54 For example, AGL's voluntary agreement in SA, which was entered into between AGL and the SA Government at the time retail prices were deregulated in SA. Through this agreement, AGL agreed to reduce the standing electricity contract price by 9.1% and maintaining that price for two years (i.e. to the end of 2014), subject to changes in network and environmental scheme costs.

– the volume of electricity consumed by the customer and their load profile.

Some specific comments made by interviewees about profit margins in each jurisdiction are set out in Table 8.2.

Table 8.2: Jurisdictional Specific Comments on Profit Margins

Jurisdiction	Comments
ACT	*'You are on the back foot in the ACT because you don't get to recover customer acquisition and retention costs, which means the margin is lower in the ACT.'*
NSW	*'There was a vicious fight for customers in NSW with deep discounting but it was not profitable.'* *'The margins in the Ausgrid area are okay but in the Essential and Endeavour distribution areas they are not particularly good.'* *'The allowances provided for by IPART for things like customer acquisition costs did not reflect the costs we would incur, so the margins available in NSW are not as cost reflective as they are in Victoria.'*
Queensland	*'In regional Queensland the margin is negative and in South East Queensland it is slightly positive.'* *'The margin has not been that great in South East Queensland given the price freeze and the subsequent decision by the QCA, but the latest draft decision by the QCA is more promising.'*
SA	*'While retail prices are no longer regulated in South Australia, AGL still has a voluntary agreement in place and that is having an effect on the market.'* *'I predict that over time there will be a greater alignment between the margins earned in Vic and SA.'* *'Prices in SA are no longer regulated, but the risks of operating in this market from a wholesale market perspective are high, so a larger risk buffer [margin] is required.'* *'Margins in South Australia are just all over the place. Some months its good, other months it's terrible. It just depends on your wholesale position.'*
Tasmania	*'The retail margin allowed by the Office of the Tasmanian Economic Regulator is commensurate with what has been allowed in other jurisdictions and it has also made provision for customer acquisition and retention costs. While the retail margin may be okay, retailers will not be able to earn a margin on the wholesale side, so the overall margin they can earn may be lower in Tasmania.'* *'While the margin in Tasmania may look attractive in dollar terms there are higher risks and the costs must be recovered from a much smaller customer base.'*
Victoria	*'Victoria has the highest margins….this reflects the risks though of the more onerous customer protection framework in Victoria.'* *'The margins in Victoria are more cost reflective than they are in other jurisdictions.'* *'We are more comfortable with the margin in Victoria than other states.'*

8.2.2 Profit margins in gas retail markets

In a similar manner to electricity, interviewees with interests in gas retailing informed us that the profit margins earned by gas retailers can differ depending on the time of year they are measured and can also differ in the following ways:

- *Across retailers* – According to interviewees, the margins earned by individual gas retailers can differ depending on:
  - their retail operating costs;
  - the price they pay for gas, transportation and other risk management tools (e.g. storage), which can vary substantially across retailers; and
  - the nature of their customer base.

  Elaborating further on these issues, one retailer stated:

  > *'The larger retailers would see a healthier margin than the smaller retailers. This is related to the price they are paying for gas but also the nature of their customer base. The risk exposure for smaller retailers is so much higher than it is for larger retailers because they are unable to attract larger customers. So the demand from their customer base tends to be more volatile. Apart from being complex to manage, this volatility can increase the price the smaller retailer has to pay for gas, transport and in an imbalance market.'*

- *Across jurisdictions* – Interviewees noted that the margins earned by gas retailers can differ across jurisdictions depending on:
  - whether retail prices are regulated[55] in that jurisdiction;
  - whether there are other voluntary pricing arrangements that influence the prices retailers charge;[56]
  - the volume of gas consumed by small customers in that jurisdiction and the variability of demand;
  - the risks associated with supplying that jurisdiction, which can differ depending on the transportation and imbalance market models and the nature of demand; and
  - the level of competition in that jurisdiction.
- *Within a jurisdiction and across customers* – Interviewees stated that the margins earned by gas retailers can differ within a jurisdiction and across customers depending on:
  - the distribution network in which their customers are located;
  - the type of customers they are supplying; and
  - the volume of gas consumed by the individual customer and their load profile.

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55 Note that NSW is the only jurisdiction that currently regulates retail gas prices for small customers.

56 For example, the voluntary agreement Origin entered into with the SA Government at the time retail prices were deregulated in SA, which involved reducing the standing gas contract price by 1%.

8.3 Victorian retail component

In the 2013 Residential Electricity Price Trends report, the AEMC found that the retail component (i.e. retail operating costs plus retail margin) in the Victorian retail electricity market in 2013 was materially higher than what it was in NSW, SA and SE Queensland.[57] Specifically, the AEMC found based on its estimates of wholesale costs, network charges and environmental scheme costs and retailers' representative market offers) that in September 2013, the retail component in Victoria ranged from 2.73-7.14 c/kWh, while in NSW it ranged from -1.57 to 2.77c/kWh, SA 1.47-4.82c/kWh and Queensland -0.15-4.27c/kWh. Given the extent of the difference between Victoria and the other jurisdictions, the AEMC signalled its intention to examine the issue further in the 2014 retail competition review.

It is in this context that we asked interviewees a series of questions about the retail component in Victoria. In short, interviewees were asked whether:

- the AEMC's findings were a surprise, or if they aligned with the interviewee's expectations; and
- the higher retail component in Victoria could be attributed to:
  - higher hedging costs in Victoria;
  - higher retail operating costs in Victoria; and/or
  - any cross subsidisation of costs from other jurisdictions by Victorian customers.

To provide a point of reference for this last group of questions, interviewees were asked to focus on differences between Victoria and NSW.

Interviewees' responses, where provided, are set out below. We note that two retailers declined to respond to this set of questions.

8.3.1 General observations about the AEMC's finding

Most interviewees we spoke to about the retail component issue informed us that while they were not surprised by the general finding that the retail component is higher in Victoria, they were surprised by the magnitude of the difference, particularly given the degree of competition in Victoria. Some illustrative comments are set out below:

> *'There is a lot of speculation that the margin in Victoria is higher than it should be. But the Victorian market is intensely competitive with about 12 active retailers, so if the margin was excessive it would be competed away.'*

> *'Measured on a range of different metrics (number of retailers, customer awareness, numbers of offers, churn and ease of changing retailers) the Victorian market is one of*

[57] AEMC, 2013 Residential Electricity Price Trends, 13 December 2013, pp. iii and xiv.

the most competitive in the world….So anyone who is not competitive in this market will lose customers.'

When asked why they were not surprised by the more general finding that the retail component is higher in Victoria, most interviewees stated that prices in Victoria are more cost reflective than they are in other jurisdictions. Some also claimed that a higher retail component is justified in Victoria because the consumer protection framework in this state gives rise to higher costs and risks for retailers. For example:

'I do think there is a difference in the profitability in Victoria, which is appropriate given the extremely interventionist consumer legislation in Victoria.'

In terms of the approach taken by the AEMC, the only real concern that was raised by a number of interviewees is that 'insufficient consideration' appeared to have been given to whether the retail prices in NSW, SE Queensland and SA that were used as the point of comparison for the Victorian market were actually 'cost reflective'. Elaborating further on this point, two interviewees stated the following:

'When you compare Victoria with NSW or SE Queensland, Victorian prices are more cost reflective than NSW or SE Queensland, because the prices in these other jurisdictions have been kept artificially low by RPR and are not, in our view, cost reflective. That is why you would see a disparity. In SA you currently have price monitoring and AGL's voluntary price agreement (which involved reducing the standing offer by 9.1%), both of which are constraining retail prices. So again prices in SA are unlikely to be truly cost reflective. I predict that over time, there will be a greater alignment between the margins earned in Victoria and SA.'

'Rather than it being an over recovery in Victoria, the retail component in other jurisdictions has been artificially depressed and should rise to the level observed in Victoria.'

A similar point was made by another interviewee, who pointed to the negative estimates for NSW and SE Queensland as an indication that the prices in these jurisdictions may not have been cost reflective or 'sustainable':

'One of challenges with the analysis is that some of the data didn't make a lot of sense. For example, the bottom end of the range for the retail component was negative in NSW and Queensland, which is clearly not sustainable. This type of result could either be an indication that there was something wrong with the data, the regulated price was too low or that the markets were in a state of unsustainable competition when the analysis was undertaken. In the case of NSW, it may well be the case that it was in a period of unsustainable competition, given the big three were competing heavily in NSW at the time the analysis was carried out.'

Apart from these general points, interviewees raised no specific issues about the methodology employed by the AEMC. To the contrary, one larger retailer stated that they had 'closely examined the methodology used by the AEMC but couldn't identify any methodological issues'.

8.3.2 Hedging costs

To determine whether hedging costs in Victoria could explain some, or all, of the observed difference in the retail component, interviewees were asked whether their hedging costs are substantially higher, lower, or roughly the same in Victoria as they are in NSW.

Responses to this question were mixed, with four interviewees stating there is unlikely to be a material difference in hedging costs across the two states, while five claimed it can be more expensive to hedge in Victoria than NSW.[58]

The factors claimed by the group of five interviewees to be contributing to higher hedging costs in Victoria can be categorised as follows:

- *Load profile* – All of the group noted that demand in Victoria is peakier[59] and more volatile than it is in NSW.
- *Wholesale prices* – All of the group noted that spot prices in the Victorian wholesale market can be more volatile than in NSW, because it is more susceptible to contagion from SA.
- *Settlement basis* – One smaller retailer noted that because the Victorian wholesale market is now settled on the basis of actual consumption, rather than the net system load profile (NSLP), retailers in Victoria are exposed to a greater degree of volatility in demand than they are in NSW.
- *Ownership of generation assets* – Another smaller retailer noted that the Victorian wholesale market is more concentrated and has a greater degree of vertical integration than the NSW market. According to this retailer, these factors have reduced the availability of hedging products in Victoria *vis-à-vis* NSW.

The purported influence of the first three of these factors on hedging costs in Victoria is reflected in the following statement made by a smaller retailer:

> *'Hedging costs and the risk premium are higher in Victoria than NSW because of the summer spikes (a lot of which is driven by the Heywood Interconnector, which gives rise to contagion from the SA market). That means retailers have to buy reallocations to avoid getting a call notice from AEMO over summer. So not only are retailers' base costs and hedging costs higher, because there is more volatility risk, but retailers have to be more reallocated to ensure they don't get a call notice. Some of the reallocation costs can add $3-$4/MWh.*
>
> *Then there are the costs associated with having to over hedge. Because the load profile can be so bad in Victoria, retailers need to over hedge. What that means is that in non-peak periods, retailers can be paying a significant amount for hedging they don't require in those periods.*

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58 Note that both of these groups consist of small and large retailers and vertically integrated and non-vertically integrated retailers. The difference in views expressed on this issue cannot therefore be attributed to these factors.

59 One smaller retailer noted that on hot days in Victoria the ratio of peak to average demand across its customer base can reach up to 300%.

> *The manner in which the Victorian market is now settled is also creating an issue. While you would think it would be better having settlement based on actual consumption rather than the NSLP, it is not. The NSLP actually provides retailers in NSW with a very predictable load shape and quite a predictable level of flex to hedge. But in Victoria retailers don't get the portfolio diversification benefits, so hedging is becoming really challenging, particularly for smaller players and new entrants.'*

8.3.3 Retail operating costs

To determine whether retail operating costs in Victoria could explain some, or all, of the observed difference in the retail component, interviewees were asked whether their operating costs are substantially higher, lower, or roughly the same in Victoria as they are in NSW.

The majority of interviewees responded to this question by stating that their retail operating costs are higher in Victoria than other jurisdictions. Some of the factors they claimed are contributing to higher retail operating costs in Victoria include:

- a more 'onerous' consumer protection framework and costly concession scheme;
- smart meters;
- higher levels of switching in Victoria; and
- a range of other factors, such as the Victorian solar feed-in tariff scheme, deviations from NECF and distribution network costs.

Further detail on the comments that were made about each of these factors is provided below.

Consumer protection framework and concession scheme

The majority of interviewees informed us that the Victorian consumer protection framework (i.e. hardship schemes, and regulations pertaining to wrongful disconnection, back billing and collections), is more 'onerous' than the framework in other jurisdictions and is giving rise to additional costs and risks for Victorian retailers. The wrongful disconnection and back billing regulations are also reportedly resulting in retailers holding higher levels of debt and for longer periods of time in Victoria than they are in other jurisdictions. Retailers also noted that the concession scheme in Victoria is more costly to administer than in other states.

Some specific comments made by interviewees about the effect of the Victorian consumer protection framework are set out below:

> *'Setting up our systems for Victoria was by a distance the most difficult. Firstly, they have an onerous and complex concession system. Secondly, they have an onerous and complex set of derogations around customer service. So they have things like the collection cycle has to be 14 days as opposed to 10 days everywhere else. They have the wrongful disconnection penalties. There is a significant raft of consumer benefits that are given in Victoria but not elsewhere. I think that's why you need a higher margin in Victoria, because from a customer protection perspective, it is absolutely interventionist and out on its own.'*

'One of the issues with Victoria is that it has a different regime around collections and disconnections, which creates another level of risk for retailers. So Victoria has the wrongful disconnection scheme, whereby if you wrongfully disconnect a customer you can be exposed to a financial penalty, which is a capped amount to be paid to the consumer. When we say wrongfully disconnect, that can be due to a technical error. For example, you have a date wrong on an application or you haven't told a customer about a concession that may be available but isn't necessarily available to them. So this creates an environment in which retailers implement a more conservative collection process, which means they hold higher levels of debt for longer in Victoria than any other jurisdiction. This exposes retailers to a greater level of risk in Victoria.'

'The hardship schemes in Victoria are more expensive and require retailers to carry higher levels of debt for longer periods of time.'

'The concession scheme in Victoria has easier eligibility criteria than in other jurisdictions.'

Smart meters

While all interviewees claimed that smart meters have resulted in higher retail operating costs in Victoria, there were mixed views about how significant this increase actually has been.

Specifically, of the nine interviewees that commented on the effect of smart meters, four claimed that the costs have *not* been significant and so were unlikely to be the primary driver of the observed difference. The other five interviewees, on the other hand, claimed that the costs have been significant because they have had to: upgrade their billing and IT systems; train staff; and spend more time with customers dealing with smart meter related complaints and providing them with their usage data.

One larger retailer that claimed smart meters have increased costs noted that it had decided to undertake a significant capital investment to deal with the interval data. While accepting that not all the investment was required from a regulatory obligation perspective, the retailer noted it was 'a commercially sound decision' to use the data in the most effective way.

Higher levels of switching

According to five of the interviewees, higher levels of switching in Victoria are giving rise to higher customer acquisition and retention costs in this state. However, another retailer noted that with larger retailers now placing greater emphasis on non-price related retention strategies, this factor was unlikely to be giving rise to significantly higher retail operating costs in Victoria.

Other factors contributing to higher retail operating costs

Some other factors that interviewees stated could be contributing to higher retail operating costs in Victoria are set out below:

- *Solar feed-in tariff scheme* – Interviewees noted that this scheme is more of an 'administrative burden' for Victorian retailers, because unlike other states where distributors carry out the administration, retailers are responsible for this in Victoria.
- *Deviations from NECF* – One larger retailer noted that deviations from NECF in Victoria are adding to the costs incurred by retailers operating in this state and other NECF jurisdictions.
- *New connections carried out by retailers* – One interviewee noted that the retail operating costs of larger retailers were probably higher in Victoria than other jurisdictions because they are carrying out a greater number of new connections for customers but are not charging connecting customers for this service.
- *Number of distributors* – One retailer observed that there are a greater number of distributors in Victoria than in NSW and that each distributor has its own process, so the administrative costs can be higher in Victoria than they are in NSW. The same retailer also noted that Victorian distributors tend to charge separate fees for a range of services, whereas NSW distributors tend to recoup the costs of the same services through regulated network tariffs. On the basis of these observations, this retailer suggested that the network cost assumptions used in the AEMC's analysis may understate the network related costs retailers in Victoria actually incur.

8.3.4 Cross subsidisation

The final question interviewees were asked on this topic is whether it was possible there was any cross subsidisation occurring between Victoria and other jurisdictions.

The majority of interviewees did not believe any cross subsidisation is occurring and pointed to the competitive constraints that would be imposed by retailers in Victoria if a retailer operating across multiple jurisdictions were to engage in this kind of behaviour. These points are reflected in the following statements made by both a smaller and large retailer operating in Victoria:

> *'I have heard that line of argument that the price freeze in Queensland caused prices to go up in Victoria. At the end of the day you have to maintain your competitive capability. Even though we were retailing in Queensland, some of our competitors in Victoria, like Simply, Red and Momentum, weren't. So we couldn't put up our prices in Victoria to compensate for Queensland, because if we did, we would have lost customers.'*

> *'…the Victorian market is competitive….So anyone who is not competitive in this market will lose customers.'*

While it was pointed out in a number of interviews that the range of prices currently offered by retailers in Victoria is quite wide and that the competitive constraint may not be as significant as suggested, interviewees maintained their view that cross subsidisation could not be sustained in Victoria.

Although cross subsidisation was ruled out by the majority of interviewees, three interviewees did note the potential for retailers to recover a greater share of their overheads from Victorian customers, because retail prices are not subject to the same regulatory constraints as they are in other jurisdictions.

The only other thought that was proffered by a smaller retailer is that there may be a degree of cross subsidisation of gas customers by electricity customers in Victoria, particularly given the significant discounts offered to dual fuel customers.

9. Future Influences on Retail Competition

The final set of questions that interviewees were asked to address were designed to elicit their views on:

- the factors that are likely to have greatest influence on competition in electricity and gas retail markets over the next five years; and
- how the structure, conduct and/or performance of electricity and gas retail markets might change over this period.

The remainder of this chapter provides an overview of the responses provided to these questions.

9.1 Influences on retail competition in the next five years

9.1.1 Electricity retail markets

The factors that interviewees informed us are likely to have the greatest effect on competition in retail electricity markets are set out below:

- *RPR* – Interviewees were broadly optimistic that the Queensland Government will remove RPR and that once that occurred, competitive conditions in SE Queensland will improve. In relation to the ACT and Tasmania, there does not appear to be any expectation that RPR will be removed in either jurisdiction in the foreseeable future.

- *Wholesale market conditions* – A number of non-vertically integrated retailers noted that if further consolidation and vertical integration in wholesale markets is to occur, it could affect their ability to access cost reflective hedging products and, in turn, their ability to compete effectively in retail markets. This group of retailers also raised concerns about future sales of government owned generation assets (e.g. Stanwell and CS Energy) and stated that before any more assets are privatised, careful consideration should be given to who the assets are to be sold to and how to structure the sale to minimise the effect on hedging and retail markets.

  On a separate but related issue, two larger vertically integrated retailers noted the potential for an oversupply of generation capacity in some regions following the closure of some large industrial loads.

- *Competition from off-grid sources* – Interviewees claimed to be facing increasing competition from off-grid sources (e.g. solar panels) and noted that if battery storage becomes more viable, it is possible that small customers may disconnect from the network and, in so doing, completely bypass retailers.

- *Competition from solar panel leasing companies* – Significant concerns were raised by a large number of interviewees about solar panel leasing companies that enter into power purchase agreements with small customers being granted an exemption from authorisation under the *National Energy Retail Law* (NERL) by the Australian Energy Regulator (AER). In effect, this exemption means that solar panel leasing companies are not subject to the same consumer protection provisions, risks and other regulatory requirements as other retailers are.[60] The retailers we spoke to about this issue, claimed that the exemption was:

– exposing small customers to a greater level of risk; and

– creating an 'uneven playing field for what is essentially the sale of the same product.

- *A retailer led deployment of smart meters* – Interviewees held mixed views about the effect that a retailer led roll out of smart meters could have on competition and customers. That is, while some claimed that small customers outside Victoria would benefit from this deployment, others claimed that it would make it more difficult for customers to switch and could create an additional barrier to entry for smaller retailers.

9.1.2 Gas retail markets

When asked what factors are likely to have greatest influence on competition in retail gas markets over the next five years, interviewees focused solely on the conditions prevailing in the wholesale gas market. As one retailer observed:

> *'Everything else in the market will be dwarfed by increase in the wholesale price brought about by the LNG developments and the higher costs of producing gas.'*

In short, most interviewees expect the LNG developments and tightening conditions in the wholesale gas market to:

- result in a significant increase in wholesale gas prices, with prices expected to converge toward the LNG netback price in some jurisdictions;
- adversely affect the ability of some retailers to access competitively priced gas;
- limit the supply options available to retailers in NSW and SA as the predominant flow of gas from the Cooper and Bowen/Surat basins shifts from south to north; and
- give rise to some additional pricing risks for retailers if the prices specified in their gas supply contracts are linked to an international oil price benchmark.

Interviewees also expect that higher wholesale gas prices will, to varying extents, flow through to retail gas prices in each jurisdiction. A number of interviewees pointed to AGL's and Origin's proposals to increase retail gas prices in NSW by 18-20% in 2014-15 as indicative of the type of increase that consumers could face and noted that an increase of this magnitude could prompt customers to switch retailers and/or reduce their demand for gas.

60 For example, an exempt retailer does not need to: develop and implement customer hardship policies; provide timely bills based on metered consumption and ensure customers have at least 13 business days to pay bills; have a dispute resolution mechanism or participate in jurisdictional Ombudsman schemes; or participate in the retailer of last resort scheme.

As to the effect these changes will have on competition in retail gas markets, a few interviewees suggested that competition could stagnate in some markets, as reflected in the following quotes:

> *'We expect LNG to disrupt and distort the market for a while and it is possible the retail market may stagnate, with new entrants deciding just to wait and see what happens until things settle down.'*
>
> *'For those retailers that don't currently retail gas, the question is do you wait and see how the market plays out or get in now? Given the changes underway you would probably just want to wait and see how it plays out.'*

The jurisdictions identified by interviewees as most affected by the changes are:

- Queensland, given its close proximity to the LNG developments; and
- NSW and SA, given their historic reliance on gas supplied from the Cooper and Bowen/Surat basins, the majority of which is now being dedicated to the LNG developments.

9.2 Changes in structure, conduct and performance of markets

Table 9.1 summarises the views expressed by interviewees about how the structure, conduct and/or performance of electricity and gas retail markets might change over the next five years.

Table 9.1: Potential Changes in Electricity and Gas Markets in the Next Five Years

<table>
<tr><th>Indicators</th><th>Electricity Retail Markets</th><th>Gas Retail Markets</th></tr>
<tr><td rowspan="2">Number of retailers</td><td colspan="2">A large number of interviewees noted the potential for some degree of consolidation to occur over the next five years. In doing so, they noted that some second tier retailers have a ‘terminal value’ strategy (i.e. building up a customer base and selling it to another retailer once a certain threshold is reached) and pointed to AGL’s recent acquisition of AP&G as an example of this type of strategy at play.

One larger retailer suggested the next transaction of this nature was more likely to involve larger second tier retailers and that if this occurred, it could result in the creation of a credible fourth player in the market.</td></tr>
<tr><td colspan="2">While some consolidation is expected to occur in the next five years, interviewees also referred to the potential for new entry to occur in both gas and electricity retail markets. They also noted the potential for new types of players to enter these markets and to offer customers a very different value proposition (e.g. offering different types of bundled products, non-price inducements and value adds). The three examples cited in this context include Macquarie Bank, Coles and Google.</td></tr>
<tr><td>Entry and expansion conditions</td><td>The removal of RPR in NSW and Queensland is expected to make it easier for retailers to enter and expand within these jurisdictions.

Concerns have been raised though by some non-vertically integrated retailers about the effect that further consolidation and vertical integration in wholesale markets will have on their ability to access cost reflective hedging products and, in turn, their ability to effectively compete in retail markets.</td><td>The only factor that interviewees really focused on in terms of entry and expansion conditions in gas retail markets is the effect that the LNG developments in Queensland will have on:
▪ the ability of retailers to access gas at competitive prices;
▪ the potential for gas supply contracts to be linked to oil prices, which would mean retailers need to find new ways to hedge this risk; and
▪ the supply options that will be available to retailers in NSW and SA.</td></tr>
<tr><td>Degree of rivalry</td><td>The only factor interviewees identified as likely to stimulate more rivalry in electricity retail markets in the next five years is the removal of RPR in those jurisdictions where it is still applied.</td><td>A few interviewees noted the potential for competition to stagnate in some retail gas markets given the effect of the LNG developments.</td></tr>
</table>

Indicators	Electricity Retail Markets	Gas Retail Markets
Product innovation	Interviewees expect a greater level of product innovation to occur in retail electricity markets over the next five years as more smart meters are rolled out. However, they have cautioned that unnecessary regulation of prices and other terms and conditions of supply could prevent customers from benefitting from these innovations.	Interviewees expect little product innovation in retail gas markets over the next five years. However, one retailer did note that it is investigating smart gas meters, which it expects would lead to product innovation.
Prices and profitability	A few interviewees noted that profit margins were likely to improve over the next five years in those jurisdictions that remove RPR 'as prices in these jurisdictions move to more cost reflective levels'.	No specific comments made.
Customer awareness	In general, interviewees expect customer awareness to improve as competition continues to evolve and through media focus on electricity prices. Some interviewees have suggested though that targeted educational campaigns may be required to: ▪ raise the level of awareness amongst small electricity customers in SE Queensland and NSW; and ▪ educate customers that are on standing contracts about the benefits of moving to a market contract.	Most interviewees noted that they expected the level of awareness amongst small gas customers to improve as higher wholesale gas prices flow through to retail gas prices and rising gas prices start to attract more media attention.
Customer switching	Interviewees noted that customer 'fatigue' may cause electricity switching to fall in some jurisdictions (e.g. Victoria); while an increased level of engagement in other jurisdictions may cause it to rise. Some interviewees also noted the potential for switching between retailers to fall as more emphasis is placed on retention strategies.	Interviewees noted the potential for significant increases in retail gas prices (brought about by tighter demand and supply conditions in the wholesale market) to prompt: ▪ a greater level of switching by gas customers; and/or ▪ a reduction in the demand for gas, with consumers switching to electricity appliances.

Appendix A. Interview and Survey Questions

A copy of the questions interview and survey participants were asked is provided below.

A.1 Interview Questions

Background Questions

57. In which jurisdictions are you currently licenced to retail:

    (a) electricity to small customers; and

    (b) gas to small customers.

58. Whether you are actively retailing in each of the jurisdictions that you hold a licence?

59. Have you wound back your operations in a particular market (gas or electricity), or are you considering doing so in the next five years? If so:

    (a) What has prompted this decision?

    (b) Are there significant costs associated with exiting or winding back operations?

60. Whether your company (or a related entity) has any upstream interests in:

    (a) electricity generation;

    (b) gas production; and/or

    (c) gas pipelines and/or electricity networks.

Electricity Questions

Ability to enter and expand in each market

Retailer's experience with entry, expansion and exit

61. Where your response to survey question 14 identifies significant barriers to *entry*, can you please provide further details on:

    (a) the sources of these barriers;

    (b) how significant the barriers are; and

    (c) where relevant, why the barriers differ across jurisdictions.

62. Where your response to survey question 15 identifies significant barriers to *expansion*, can you please provide further details on:

(a) the sources of these barriers;

(b) how significant the barriers are; and

(c) where relevant, why the barriers differ across jurisdictions.

63. Is there anything that you think can be done to reduce these barriers, or do you think they will persist in the future?

64. To what extent are *differences* in the following factors making it difficult for retailers to enter and/or expand across multiple jurisdictions:

(a) licensing requirements?

(b) regulations?

(c) environmental schemes?

(d) other factors?

65. To what extent has NECF reduced any of these impediments in the jurisdictions it has been implemented? Is it now easier to enter or expand in those jurisdictions that have implemented NECF?

66. Has the removal of retail price regulation in Victoria and South Australia had any effect on the barriers to entry and/or expansion in these jurisdictions?

Economies of scale, scope and vertical integration

67. Is there a minimum number of customers you need to supply to make entry viable? If so:

(a) What is this number and does it differ across jurisdictions?

(b) To what extent is this number related to your retail business model?

68. Focusing on your responses to survey questions 16-18, can you explain the ratings you have assigned to the importance of the following factors in each jurisdiction:

(a) economies of scale;[61]

(b) economies of scope (e.g. offering dual fuel or multi-utility products);[62] and

(c) vertical integration (e.g. interests in electricity generation or electricity networks).

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[61] The term 'economies of scale' is used in this context to refer to a situation where retailer's long run average cost declines as the size of its customer base increases. This may occur if a retailer has significant fixed or sunk costs.

[62] The term 'economies of scope' refers to a situation where the unit cost of supplying two or more products or services (e.g. gas and electricity) is lower for a given level of output than if those products or services were supplied by two separate retailers.

Retailer rivalry

Manner in which retailers compete

69. In those jurisdictions that you are active:

    (a) On what basis do retailers currently compete (e.g. price rivalry[63] vs non-price rivalry[64])?

    (b) Are any of these forms of competition more or less important?

Rivalry

70. Based on your responses to survey questions 20-22 on the degree of rivalry amongst retailers:

    (a) What distinguishes those jurisdictions with a high degree of rivalry from those with a low degree of rivalry?

    (b) Are there specific issues affecting rivalry in those jurisdictions assigned a low rating?

    (c) What, if any, effect has retail price regulation had on rivalry in the jurisdictions it is applied? Has its removal had any effect on rivalry in Victoria or South Australia?

    (d) Has there been a change in the degree of rivalry in any jurisdiction in the last two years?

Products and service offerings

Product differentiation

71. How do you distinguish your products from those offered by other retailers?[65]

72. Does the number of products offered by larger retailers differ from those offered by second tier retailers? If so, why?

73. What types of discounts, rebates and/or incentives are you currently offering?

    (a) Do you think customers understand the different discount structures offered by retailers?

    (b) To what extent do the discounts, rebates and/or incentives you offer differ between:

---

63 Price rivalry can take a number of forms including discounts, rebates and alternative tariff structures.

64 Non-price rivalry can take a number of forms including service, incentives, bundling products, non-price contract terms.

65 Examples include price discounts, rebates, alternative tariff structures, customer service, fixed term contracts, fixed benefit periods, fixed price contracts or bundling with other products.

i. jurisdictions?

ii. customer types (e.g. residential vs small business)?

iii. customer characteristics (e.g. appliances installed, size of consumption etc)?

If they do differ, what jurisdictions, customer types and/or customer characteristics are currently attracting the most favourable offers versus the least favourable offers?

74. To what extent do customer preferences influence your product offerings?

Product innovation

75. Based on your response to survey question 24 on product innovation, what are the key differences between those jurisdictions assigned a high and low rating?

76. Are there any specific factors impeding innovation?[66] If so, is there anything that can be done to remove these impediments?

77. What, if any, effect does retail price regulation have on product differentiation and innovation? Have you observed any change in the degree of product differentiation and innovation in those jurisdictions where retail price regulation has been removed?

Dual fuel and multi-fuel products

78. How important do you think it is to be able to offer both gas and electricity, either through a dual fuel or multi-utility product? Does the importance differ by jurisdiction?

Fixed term, fixed price and/or fixed benefit period contracts

79. If in your response to survey question 57 you indicated that you do offer fixed term, fixed price and/or fixed benefit period contracts, can you briefly explain:

(a) What is fixed under these contracts?

(b) How often the rates under these types of contracts are typically varied and the main reasons for such variations?

(c) How significant the variations typically are?

80. For retailers that are not currently offering these types of contracts, is there a reason why you have chosen not to market these products?

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66 Some potential impediments include access to quality data, technology, network tariff structures, retail price regulation or other forms of regulation.

Marketing and retention strategies

Marketing strategies

81. Thinking about the strategy underlying your marketing campaigns, please answer the following questions:
    (a) What type of customers do you try and target with your marketing campaigns? Are there any types of customers that you do not target? If so, why?

82. What marketing channels do you currently use (e.g. television, radio, newspapers, online (website and social media), outdoor advertising and/or door knocking)?
    (a) Do you expect any of these marketing channels to become more important in the future?

83. Where your response to survey question 27 indicates that average customer acquisition costs differ across jurisdictions, can you explain why you think they differ?

84. Does the amount of time you need to spend educating customers on their ability to choose their retailer differ in each jurisdiction?

Retention strategies

85. What are your key retention strategies?
    (a) How effective have these strategies been?
    (b) At what point are your retention strategies triggered?
    (c) Do you target particular customers when implementing these strategies?

Pricing and profit margins

Prices

86. In those jurisdictions that have retail price regulation, to what extent does the standing contract and regulated tariff acts as the focal point for the prices offered in market contracts?

87. What benchmarks do retailers use in those jurisdictions where regulation has been removed?

Profit margins

88. Thinking about your response to survey question 28, is there a material difference between the profit margins available in each jurisdiction? If so:
    (a) What would you attribute this difference to?
    (b) Has this changed in the last two years?
89. Within each jurisdiction, is there a particular customer characteristic(s) (such as size, types of appliances installed, suburb location etc.) that makes a customer more profitable?

Retail component of retail prices

In the recent Residential Electricity Price Trends report, the AEMC found that the retail component (i.e. retail operating costs plus retail margin) of the representative market offer price in Victoria was far higher than the retail component in NSW, Qld and SA (Victoria: 2.73–7.14 c/kWh vs NSW: -1.57–2.77 c/kWh).

90. Does this finding surprise you, or does it accord with your own experience/expectations?
91. What, if anything, do you think this finding indicates about:
    (a) the effectiveness of retail competition in Victoria?
    (b) the effectiveness of competition in the wholesale market in Victoria?

Victoria versus NSW (to be answered by retailers operating in these two jurisdictions)

To enable a more meaningful comparison of the potential sources of the higher retail component in Victoria, the following questions focus on differences between Victoria and NSW.

92. In your experience, is the retail margin (measured on a per customer basis) substantially higher, lower or roughly the same in Victoria than it is in NSW?
93. Are hedging costs substantially higher, lower or roughly the same in Victoria as they are in NSW? If they are higher, to what extent can this be explained by differences in:
    (a) the hedging strategies employed by retailers across the two states?
    (b) the availability of hedging contracts in the two states?
    (c) the level of competition in the wholesale market in the two states?
    (d) other factors?

    Please provide further detail on any of the factors you think could explain the higher hedging costs in Victoria.

94. Are the retail operating costs (excluding wholesale, transmission and distribution costs) you incur when serving small customers (measured on a per customer basis) substantially higher, lower or roughly the same in Victoria as they are in NSW?

    (a) If they are higher, to what extent can this be explained by *differences* in:

        i. regulatory obligations and regulatory costs (including the costs of ombudsmen)?

        ii. service levels or the range of products offered?

        iii. the amount spent on marketing?

        iv. the degree of switching by small customers, to the extent this affects acquisition or retention costs?

        v. exit fees?

        vi. other factors?

        Please provide further detail on any of the factors you think could explain the higher retail operating costs in Victoria.

    (b) Has the introduction of smart meters in Victoria resulted in higher retail operating costs in this state? If so, please explain why and how significant the increase has been.

95. Does the manner in which you allocate retail operating costs between customer types (i.e. residential, small business and large users) differ in Victoria and NSW? If so, how does it differ and could this explain any of the difference for small customers?

96. Do you think differences in the nature of consumption in Victoria versus NSW could explain any of the difference?

97. Do you think there is any cross subsidisation occurring between Victoria and NSW (or other jurisdictions that are subject to retail price regulation), given the price that can be charged in NSW is effectively capped by the regulated tariff? If this is occurring, why is the price charged by retailers only operating in Victoria not constraining this behaviour?

98. Are there any other factors that you think could explain some, or all of, the difference?

Exercise of choice by customers

Customer characteristics

99. If your responses to survey questions 29-31 indicate there are differences in the level of customer awareness, the degree of switching and/or stickiness[67] across jurisdictions:

    (a) Can you explain why you think there are these differences?

    (b) Do you expect this to change in the next five years? If so, what will prompt this change?

100. Do differences in level of customer awareness, switching and/or stickiness affect your product offerings and/or the way in which you market your products across jurisdictions?

101. Are there customer groups that have less access to competitive offers than others (e.g. customers with special needs, non-English speaking customers and low income earners)?

Customer switching

102. What do you think prompts customers to switch? Does this differ across customer types (e.g. residential versus small business) and/or jurisdictions?

103. Do you think there are any impediments to customers switching? If so, what are they and can anything be done to remove or reduce them?

Tasmania

104. With the advent of FRC in Tasmania, would you consider entering this market? If so, what barriers to entry and/or expansion do you expect to face?

105. How do you think rivalry may evolve in Tasmania?

106. Once FRC is introduced, how long do you think it will take before a reasonable proportion of customers are willing to switch from:

    (a) standing offers to market offers?

    (b) the incumbent retailer to new entrant retailers?

107. Are there likely to be any specific impediments to customers switching in Tasmania?

[67] The term 'stickiness' is used in this context to refer to customers that either don't respond, or are very slow to respond, to higher prices by switching to lower priced contracts or other retailers.

Overall level of competition

108. Thinking about your response to survey question 32 on the level of competition in each market:

(a) What distinguishes the jurisdictions that are relatively competitive from those that are less competitive?

(b) In those jurisdictions that are less competitive, do you expect to see any change over the next five years? If so, what do you think will prompt this change?

109. How successful do you think second tier retailers have been in these jurisdictions?

Future developments

110. Looking forward over the next five years, do you think there will be any changes in:

(a) the structure of the markets in each jurisdiction, i.e.:

i. Are new retailers likely to enter these markets?

ii. Is the market concentration likely to diminish or increase?

iii. Are any retailers likely to exit these markets?

(b) the ease with which retailers can enter or expand in any of the jurisdictions?

(c) the degree of rivalry in each jurisdiction?

(d) the products and services offered by retailers?

(e) the profit margins earned in each of the jurisdictions?

(f) the level of customer awareness and customer switching?

111. Are there any specific issues that you think will affect competition in any of the jurisdictions over the next five years?[68]

112. Are there any other issues you wish to raise?

[68] For example, changes in demand and/or customer preferences, conditions in the wholesale market, the implementation of NECF, the removal of retail price regulation, changes in climate change policies, other changes in government policies and/or the regulatory framework, privatisation.

South East Queensland Retail Electricity Market

As part of this review, the AEMC will be undertaking a more detailed review of competition in the South East Queensland retail electricity market. A specific set of questions has therefore been developed for this market, which we would like to ask those retailers currently operating in this market, and any retailers currently considering entering this market.

Ability to enter or expand

113. In addition to the general answers already given, do you have any specific comments on:

(a) The ease with which retailers can enter and/or expand in this market?

(b) The extent to which there are any barriers to retailing electricity in rural and/or regional areas in this market?

(c) The importance of economies of scale, scope or vertical integration in this market?

(d) The effect of retail price regulation on the barriers to entry and/or expansion in this market?

Retailer rivalry

114. In addition to the general answers already given, do you have any specific comments on:

(a) The manner in which retailers compete in this market?

(b) The degree of rivalry in this market?

(c) How rivalry has changed in the last two years and how it may change in the next five years?

(d) The effect of retail price regulation on rivalry in this market?

(e) The degree of rivalry in urban areas versus rural or regional areas of Queensland?

Products and services offered

115. In addition to the general answers already given, do you have any specific comments on:

(a) The types of products you currently offer in this market?

(b) How you distinguish your products from other retailers in this market?

(c) The discounts, rebates and/or incentives offered in this market compared to those in other markets?

(d) The extent to which discounts, rebates and incentives differ in rural/regional areas?

(e) Product innovation in this market and whether there are any specific impediments to innovation in this market?

Marketing and retention strategies

116. In addition to the general answers already given, do you have any specific comments on:

(a) The marketing and retention strategies employed in this market?

(b) The types of customers you target in this market?

(c) The amount of time you spend educating customers about their ability to choose a retailer?

Prices and profit margins

117. In addition to the general answers already given, do you have any specific comments on:

(a) The extent to which the regulated tariff act as the focal point for the prices offered in market contracts and price based competition?

(b) How profit margins in this market compare with those in other jurisdictions?

(c) The effect that the removal of retail price regulation may have on prices and profit margins?

Exercise of customer choice

118. In addition to the general answers already given, do you have any specific comments on:

(a) The level of awareness that customers in this market have about their ability to switch?

(b) The level of ‘stickiness’ exhibited by customers in this market?

(c) The degree of switching in this market?

(d) Whether there are any specific impediments to switching in this market?

Effect of the removal of retail price regulation

119. What do you think will occur in this market if retail price regulation is removed?

Future developments

120. In addition to the general answers already given, do you have any specific comments on:

    (a) What you think this retail electricity market is likely to look like in five years' time?

    (b) Whether there are specific issues you think are likely to affect competition in this market?

121. Are there any other issues you wish to raise about this market?

Gas Questions

Ability to enter and expand in each market

Barriers to entry, expansion and exit across the jurisdictions

122. Where your response to survey question 38 identifies significant barriers to *entry*, can you please provide further details on:

(a) the sources of these barriers;

(b) how significant the barriers are; and

(c) where relevant, why the barriers to entry differ across jurisdictions.

123. Where your response to survey question 39 identifies significant barriers to *expansion*, can you please provide further details on:

(a) the sources of these barriers;

(b) how significant the barriers are; and

(c) where relevant, why the barriers to expansion differ across jurisdictions.

124. Are there barriers to exit in any jurisdiction? If so, can you please provide further details on:

(a) the sources of these barriers;

(b) how significant the barriers are; and

(c) where relevant, why the barriers to exit differ across jurisdictions.

125. Is there anything that you think can be done to reduce the barriers to entry, expansion and/or exit, or do you think they will persist in the future?

126. To what extent are *differences* in the following factors making it difficult for retailers to enter and/or expand across multiple jurisdictions:

(a) licensing requirements?

(b) regulations?

(c) market design, i.e. STTM vs DWGM?

(d) transmission carriage models, i.e. contract vs market carriage?

(e) other factors?

Economies of scale, scope and vertical integration

127. Focusing on your responses to survey questions 40-42, can you explain the ratings you have assigned to the importance of the following factors in each jurisdiction:

(a) economies of scale;

(b) economies of scope (e.g. offering gas as part of a dual fuel or multi-utility products); and

(c) vertical integration (e.g. interests in gas production).

128. Is there a minimum number of customers you need to supply to make entry viable? If so:

(a) What is this number and does it differ across jurisdictions?

(b) To what extent is this number related to your retail business model?

Retailer rivalry

Manner in which retailers compete

129. In those jurisdictions in which you are active:

(a) On what basis do retailers currently compete (e.g. price rivalry vs non-price rivalry)?

(b) Are any of these forms of competition more or less important?

(c) Does the form of competition differ depending on the jurisdiction and/or the type of customer (e.g. residential vs small business)?

Rivalry

130. Based on your responses to survey questions 44-46 on the degree of rivalry amongst retailers:

(a) What distinguishes those jurisdictions with a high degree of rivalry from those with a low degree of rivalry?

(b) Are there specific issues affecting rivalry in those jurisdictions assigned a low rating?

(c) Has there been a change in the degree of rivalry in any jurisdiction in the last two years?

Products and service offerings

131. What type of products do you currently offer, and in which jurisdictions? If products vary across jurisdictions, why?

Product innovation

132. Does the level of product innovation differ for gas and electricity products?

133. Is there any difference between the degree of product differentiation and innovation in NSW and other jurisdictions that do not apply retail price regulation?

Marketing and retention strategies

134. To what extent do your marketing and retention strategies differ from those adopted in electricity? If there are some differences, please explain what they are.

135. Do you market gas separately or as part of dual fuel campaigns? If separately:

    (a) Does the way in which you market your gas products differ across jurisdictions?

    (b) Has the amount you spent on marketing your gas products changed over the last two years and do you expect it to change over the next five years?

136. Where your response to survey question 51 indicates that average customer acquisition costs differ across jurisdictions, can you explain why you think they differ?

Pricing and profit margins

Prices

137. To what extent does the standing contract and regulated tariff act as the focal point for the prices offered in market contracts in NSW?

138. What benchmarks do retailers use in other jurisdictions?

Profit margins

139. Thinking about your response to survey question 52, is there a material difference between the profit margins available in each jurisdiction? If so:

    (a) What would you attribute this difference to?

    (b) Which jurisdictions do you think are the most profitable vs least profitable?

    (c) Has this changed in the last two years?

140. Is there a material difference between the margins available in gas and electricity markets?

141. Within each jurisdiction, is there a particular customer characteristic(s) (such as size, types of appliances installed, suburb location etc.) that makes a customer more profitable?

Exercise of choice by customers

Customer characteristics

142. To what extent do the observations you have made about the level of customer awareness, the degree of switching and the stickiness of electricity customers hold for gas customers? If there are some differences, please explain what they are.

Customer switching

143. To what extent do you think switching by gas customers is related to electricity switching?

144. In NSW how common is it for customers to switch from back to a standing contract?

145. Do you think there are any impediments to gas customers switching? If so, what are they and can anything be done to remove or reduce them?

Overall level of competition

146. Thinking about your response to survey question 56 on the level of competition in each market:

    (a) What distinguishes the jurisdictions you think are relatively competitive from those that you think are less competitive?

    (b) In those jurisdictions that are less competitive, do you expect to see any change over the next five years? If so, what do you think will prompt this change?

147. How successful do you think second tier retailers have been in capturing market share in each jurisdiction?

148. How different is the level of competition between gas and electricity retail markets?

Future developments

149. Looking forward over the next five years, do you think there will be any changes in:

    (a) The structure of the markets in each jurisdiction, i.e:

i. Are new retailers likely to enter these markets?

ii. Is the degree of market concentration likely to diminish or increase?

iii. Are any retailers likely to exit these markets?

(b) The ease with which retailers can enter or expand in any of the jurisdictions?

(c) The degree of rivalry in each jurisdiction?

(d) The profit margins earned in each of the jurisdictions?

(e) The products and services offered by retailers?

(f) The level of customer awareness and switching?

150. What, if any, effect do you think the tightening conditions in the wholesale gas market will have on the factors set out in (a)-(e)?

151. Are there any other significant issues that you think will affect competition in this period?

152. Are there any other issues you wish to raise?

Survey Questions: Electricity Background Questions

The table below contains a number of background questions that we would like to obtain your responses to. Please set out your responses in the relevant column using the instructions set out in the purple shaded column.

Company name: ______________________________________

Background Questions – Electricity

Questions		Please respond in the following way	ACT	New South Wales	Queensland		South Australia	Tasmania	Victoria
					South East Qld	Remainder			
1	In which jurisdictions do you currently hold a *licence* to retail electricity to small customers?	✓ or ×							
2	In which jurisdictions are you *actively retailing* electricity to small customers?	✓ or ×							
3	When did you start retailing in these jurisdictions?	Approximate month and year							
4	Are you offering services in urban, rural and/or regional areas in these jurisdictions?	State whether urban, rural and/or regional							
5	If you are supplying rural and/or regional areas, are there any geographic areas you do not supply in these jurisdictions?	Identify the general geographic area							
6	Are you offering services to residential and small businesses?	✓ or if one category only identify category							
7	Has the number of small customers you supply grown in the last two years?	Yes or No							
8	What is your approximate market share in each jurisdiction?	Approximate %							
9	Has this changed over the last two years?	State whether increased, decreased or unchanged							
10	What is your company's strategy for each jurisdiction over the next five years?	State whether considering entry, expansion or exit or unchanged							

Electricity Survey Detailed Questions

The table below contains more detailed questions on the ability of electricity retailers to enter and expand, retailer rivalry, product and service offerings, marketing strategies, prices and profit margins and the exercise of choice by customers across each jurisdiction. The responses to the questions contained in this table should be based on your own experience. Retailers should therefore only provide responses for particular jurisdictions if they are currently operating in that jurisdiction, have previously operated in that jurisdiction or have considered operating in that jurisdiction. In all other cases, retailers should just place a n.a. in the relevant jurisdictional column. Please set out your responses in the relevant column using the instructions set out in the blue shaded column.

Electricity Survey

<table>
<tr><th colspan="2" rowspan="2">Questions</th><th rowspan="2">Please respond in the following way</th><th rowspan="2">ACT</th><th rowspan="2">New South Wales</th><th colspan="2">Queensland</th><th rowspan="2">South Australia</th><th rowspan="2">Tasmania</th><th rowspan="2">Victoria</th></tr>
<tr><th>South East Qld</th><th>Remainder</th></tr>
<tr><td colspan="10">Ability to enter and expand</td></tr>
<tr><td>11</td><td>How would you rate the ease with which entry can occur in each jurisdiction on a scale of 0 to 5?</td><td rowspan="3">Rating: 0 to 5, where 0 means very difficult and 5 means very easy</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>12</td><td>How would you rate the ease with which expansion can occur in each jurisdiction on a scale of 0 to 5?</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>13</td><td>How would you rate the ease with which exit can occur in each jurisdiction on a scale of 0 to 5?</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>14</td><td>To the extent there are barriers to entry, please identify the most significant barriers in order of importance.
Some potential sources of these barriers include:
1. Access to, and/or price of, wholesale energy and hedging arrangements.
2. Access to transmission or distribution network.
3. Prudential and network credit requirements.
4. Environmental policies.
5. Retail price regulation in those jurisdictions where it is still imposed.
6. Retail licence requirements.
7. Other state or federal government regulatory requirements.
8. Economies of scale.</td><td>Identify the most significant barriers in order of importance using the same numbering system used for the potential sources.
For example, if environmental policies are considered a significant barrier, put 4 in the relevant column.
If there are other sources not listed, please provide further</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

Questions		Please respond in the following way	ACT	New South Wales	Queensland		South Australia	Tasmania	Victoria
					South East Qld	Remainder			
15	To the extent there are barriers to *expansion*, please identify the most significant barriers in order of importance.								
16	On a scale of 0 to 5, how important are economies of scale in terms of being able to compete effectively in each jurisdiction[69]								
17	On a scale of 0 to 5, how important are economies of scope in terms of being able to compete effectively in each jurisdiction?[70]	Rating: 0 to 5, where 0 means not important and 5 means very important							
18	On a scale of 0 to 5, how important is having an interest in electricity generation in terms of being able to compete effectively in each jurisdiction?								
19	Are there additional barriers to retailing electricity in rural and/or regional areas?	Yes or No							
				Retailer rivalry					
20	How would you rate the degree of *price* rivalry[71] in each jurisdiction, on a scale of 0 to 5?								
21	How would you rate the degree of *non-price*[72] rivalry in each jurisdiction, on a scale of 0 to 5?	Rating: 0 to 5, where 0 means no rivalry and 5 means highly competitive							
22	How would you rank the *overall* degree of rivalry amongst retailers in each jurisdiction, on a scale of 0 to 5?								
23	Does the degree of rivalry differ in urban vs rural and/or regional areas?	Yes or No							

69 The term 'economies of scale' refers to a situation where a retailer's long run average cost declines as the size of its customer base increases. This may occur if a retailer has significant fixed or sunk costs.

70 The term 'economies of scope' refers to a situation where the unit cost of a retailer supplying two or more products or services (e.g. gas and electricity) is lower for a given level of output than if those products or services were supplied by two separate retailers.

71 Price rivalry can take a number of forms including discounts, rebates and alternative tariff structures.

72 Non-price rivalry can take a number of forms including customer service, incentives, bundling products, non-price contract terms.

Questions		Please respond in the following way	ACT	New South Wales	Queensland		South Australia	Tasmania	Victoria
					South East Qld	Remainder			
Product and service offerings									
24	How would you rate the degree of product differentiation and innovation in each jurisdiction on a scale of 0 to 5?	Rating: 0 to 5, where 0 means no differentiation or innovation and 5 means highly differentiated and innovative							
25	How important is it to be able to offer dual fuel or multi-fuel products in each jurisdiction, on a scale of 0 to 5?	Rating: 0 to 5, where 0 means not important and 5 means very important							
Marketing strategies									
26	Has the amount spent on marketing increased, decreased or remained flat in each jurisdiction over the last two years?	State if expenditure increased, decreased or remained flat							
27	What are your average customer acquisition costs in each jurisdiction?	Please respond by selecting one of the following ranges: $0-$50; $51-$100; $101-$150; $151-$200; $201-$250 $251-$300 Greater than $300							
Prices and profit margins									
28	How would you rate the profitability of retailing in each jurisdiction, on a scale of 0 to 5?	Rating: 0 to 5, where 0 means not profitable and 5 means very profitable							

<table>
<tr><th colspan="2" rowspan="2">Questions</th><th rowspan="2">Please respond in the following way</th><th rowspan="2">ACT</th><th rowspan="2">New South Wales</th><th colspan="2">Queensland</th><th rowspan="2">South Australia</th><th rowspan="2">Tasmania</th><th rowspan="2">Victoria</th></tr>
<tr><th>South East Qld</th><th>Remainder</th></tr>
<tr><td colspan="10">Exercise of choice by customers</td></tr>
<tr><td>29</td><td>How would you rate the level of awareness amongst customers of their ability to switch in each jurisdiction on a scale of 0 to 5?</td><td rowspan="2">Rating: 0 to 5, where 0 means non-existent, 3 means moderate and 5 means very high</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>30</td><td>How would you rate the level of switching amongst small customers in each jurisdiction, on a scale of 0 to 5? Switching in this context refers to:
▪ switching between retailers; and
▪ changing from a standing offer to a market offer or switching between market offers with the same retailer.</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>31</td><td>How would you rate the level of ‘stickiness’[73] exhibited by customers in each jurisdiction, on a scale of 0 to 5?</td><td>Rating: 0 to 5, where 0 means very sticky and 5 means not sticky</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td colspan="10">Overall level of competition</td></tr>
<tr><td>32</td><td>How would you rate the overall level of competition in each jurisdiction, on a scale of 0 to 5?</td><td>Rating: 0 to 5, where 0 means no competition and 5 means effectively competitive.</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

[73] The term ‘stickiness’ is used in this context to refer to customers that either don’t respond, or are very slow to respond, to higher prices by switching to lower priced contracts or other retailers.

Questions		Please respond in the following way	ACT	New South Wales	Queensland		South Australia	Tasmania	Victoria
					South East Qld	Remainder			
TO BE COMPLETED BY RETAILERS SELLING ELECTRICITY ONLY									
33	If you are <u>not</u> currently retailing gas, please identify whether you think the barriers to entry to the retail gas markets in each jurisdiction are low, medium or high?	Low, medium or high							
34	If your response to question 33 indicated that the barriers to entry were medium or high, please identify the most significant barriers in order of importance. Some potential sources of these barriers include: 1. Access to, and/or price of, gas. 2. Access to, and/or price of, transmission pipeline capacity (or delivery points). 3. Access to, and/or price of, distribution pipeline capacity (or delivery points). 4. Requirement to participate in the STTM and/or DWGM, where relevant. 5. Prudential requirements for STTM and/or DWGM, where relevant. 6. Retail price regulation in those jurisdictions where it is still imposed. 7. Retail licence requirements. 8. Other state or federal government regulatory requirements. 9. Economies of scale.	Identify the most significant barriers in order of importance using the same numbering system used for the potential sources. For example, if retail licence requirements are considered a significant barrier, put 7 in the relevant column. If there are other sources not listed, please provide further detail on these.							

Survey Questions: Gas Background Questions

The table below contains a number of background questions that we would like to obtain your responses to. Please set out your responses in the relevant column using the instructions set out in the blue shaded column.

Company name: ___________________________________

Table 1: Background Questions – Gas

Questions		Please respond in the following way	ACT	New South Wales	Queensland		South Australia	Tasmania	Victoria
					South East Qld	Remainder			
1	In which jurisdictions do you currently hold a *licence* to retail gas to small customers?	✓ or ×							
2	In which jurisdictions are you *actively retailing* gas to small customers?	✓ or ×							
3	When did you start retailing in these jurisdictions?	Approximate month and year							
4	Are you offering services in urban, rural and/or regional areas in these jurisdictions?	State whether urban, rural and/or regional							
5	If you are supplying rural and/or regional areas, are there any geographic areas you do not supply in these jurisdictions?	Identify the general geographic area							
6	Are you offering services to residential and small businesses?	✓ or if one category only identify category							
7	Approximately how many small customers do you supply in each jurisdiction?	Approximate number							
8	Has the number of small customers you supply grown in the last two years?	Yes or No							
9	What is your approximate market share in each jurisdiction?	Approximate %							
10	Has this changed over the last two years?	State whether increased, decreased or unchanged							
11	What is your company's strategy for each jurisdiction over the next five years?	State whether considering entry, expansion or exit or unchanged							

Gas Survey Detailed Questions

The table below contains more detailed questions on the ability of gas retailers to enter and expand, retailer rivalry, product and service offerings, marketing strategies, prices and profit margins and the exercise of choice by customers across each jurisdiction. If you don't currently retail gas please <u>don't</u> complete this table.

If you are currently retailing gas, your responses should be based on your own experience. You should therefore only provide responses for particular jurisdictions if you are currently operating in that jurisdiction, have previously operated in that jurisdiction or have considered operating in that jurisdiction. In all other cases, just place a n.a. in the relevant jurisdictional column. Please set out your responses using the instructions set out in the green shaded column.

Gas Survey

Questions		**Please respond in the following way**	**ACT**	**New South Wales**	**Queensland**		**South Australia**	**Tasmania**	**Victoria**
					South East Qld	**Remainder**			
				Ability to enter and expand					
12	How would you rate the ease with which *entry* can occur in each jurisdiction on a scale of 0 to 5?	Rating: 0 to 5, where 0 means very difficult and 5 means very easy							
13	How would you rate the ease with which *expansion* can occur in each jurisdiction on a scale of 0 to 5?								
14	How would you rate the ease with which *exit* can occur in each jurisdiction on a scale of 0 to 5?								
15	To the extent there are barriers to entry, please identify the most significant barriers in order of importance. Some potential sources of these barriers include: 1. Access to, and/or price of, gas. 2. Access to, and/or price of, transmission pipeline capacity (or delivery points). 3. Access to, and/or price of, distribution pipeline capacity (or delivery points). 4. Requirement to participate in the STTM and/or DWGM, where relevant. 5. Prudential requirements for STTM and/or DWGM, where relevant. 6. Retail price regulation in those jurisdictions where it is still imposed. 7. Retail licence requirements. 8. Other state or federal government regulatory requirements. 9. Economies of scale.	Identify the most significant barriers in order of importance using the same numbering system used for the potential sources. For example, if retail licence requirements are considered a significant barrier, put 7 in the relevant column. If there are other sources not listed, please provide further detail on these.							

Questions		Please respond in the following way	ACT	New South Wales	Queensland		South Australia	Tasmania	Victoria
					South East Qld	Remainder			
16	To the extent there are barriers to *expansion*, please identify the most significant barriers in order of importance.								
17	On a scale of 0 to 5, how important are economies of scale in terms of being able to compete effectively in each jurisdiction?	Rating: 0 to 5, where 0 means not important and 5 means very important							
18	On a scale of 0 to 5, how important are economies of scope in terms of being able to compete effectively in each jurisdiction?								
19	On a scale of 0 to 5, how important is having an interest in upstream production in terms of being able to compete effectively in each jurisdiction?								
20	Are there additional barriers to retailing gas in rural and/or regional areas?	Yes or No							
Retailer rivalry									
21	How would you rate the degree of *price* rivalry in each jurisdiction, on a scale of 0 to 5?	Rating: 0 to 5, where 0 means no rivalry and 5 means highly competitive							
22	How would you rate the degree of *non-price* rivalry in each jurisdiction, on a scale of 0 to 5?								
23	How would you rank the *overall* degree of rivalry amongst retailers in each jurisdiction, on a scale of 0 to 5?								
24	Does the degree of rivalry differ in urban vs rural and/or regional areas?	Yes or No							
Product and service offerings									
25	How would you rate the degree of product differentiation and innovation in each jurisdiction on a scale of 0 to 5?	Rating: 0 to 5, where 0 means no differentiation or innovation and 5 means highly differentiated and innovative							

Questions		Please respond in the following way	ACT	New South Wales	Queensland		South Australia	Tasmania	Victoria
					South East Qld	Remainder			
26	How important is it to be able to offer gas as part of a dual fuel or multi-fuel product in each jurisdiction, on a scale of 0 to 5?	Rating: 0 to 5, where 0 means not important and 5 means very important							
		Marketing strategies							
27	Has the amount spent on marketing increased, decreased or remained flat in each jurisdiction over the last two years?	State if expenditure increased, decreased or remained flat							
28	What are your average customer acquisition costs in each jurisdiction?	Please respond by selecting one of the following ranges: $0-$50; $51-$100; $101-$150; $151-$200; $201-$250 $251-$300 Greater than $300							
		Prices and profit margins							
29	How would you rate the profitability of retailing in each jurisdiction, on a scale of 0 to 5?	Rating: 0 to 5, where 0 means not profitable and 5 means very profitable							
		Exercise of choice by customers							
30	How would you rate the level of awareness amongst customers of their ability to switch in each jurisdiction on a scale of 0 to 5?	Rating: 0 to 5, where 0 means non-existent, 3 means moderate and 5 means very high							
31	How would you rate the level of switching amongst small customers in each jurisdiction, on a scale of 0 to 5? Switching in this context refers to: ▪ switching between retailers; and ▪ changing to different plans with the same retailer.								

Questions		Please respond in the following way	ACT	New South Wales	Queensland		South Australia	Tasmania	Victoria
					South East Qld	Remainder			
32	How would you rate the level of 'stickiness' exhibited by customers in each jurisdiction, on a scale of 0 to 5?	Rating: 0 to 5, where 0 means very sticky and 5 means not sticky							
Overall level of competition									
33	How would you rate the overall level of competition in each jurisdiction, on a scale of 0 to 5?	Rating: 0 to 5, where 0 means no competition and 5 means effectively competitive.							