

REVIEW

Australian Energy Market Commission

CONSULTATION PAPER

2015 Retail Competition Review

31 October 2014

Inquiries

Australian Energy Market Commission
PO Box A2449
Sydney South NSW 1235

E: aemc@aemc.gov.au

T: (02) 8296 7800

F: (02) 8296 7899

Reference: RPR0003

Citation

AEMC 2014, 2015 Retail Competition Review, Consultation Paper, 31 October 2014, Sydney

About the AEMC

The AEMC reports to the Council of Australian Governments (COAG) through the COAG Energy Council. We have two functions. We make and amend the national electricity, gas and energy retail rules and conduct independent reviews for the COAG Energy Council.

This work is copyright. The Copyright Act 1968 permits fair dealing for study, research, news reporting, criticism and review. Selected passages, tables or diagrams may be reproduced for such purposes provided acknowledgement of the source is included.

Contents

1	Introduction	1
1.1	Purpose of this Consultation paper	1
1.2	Scope of this review	1
1.3	Process for this review.....	3
1.4	Submissions	4
2	Background to this review.....	5
2.1	Retail energy market competition in NEM jurisdictions.....	5
3	Assessment framework for the 2015 review	7
3.1	Stocktake of relevant projects.....	7
3.2	Differences between the 2014 and 2015 approach.....	9
3.3	Data time frames	11
3.4	Market definition	11
3.5	Competitive market indicators.....	11
A	Questions for stakeholder submissions	14

1 Introduction

The Australian Energy Market Commission (AEMC) is responsible under the Australian Energy Market Agreement for assessing the state of competition in electricity and natural gas retail markets.

In December 2012, the Council of Australian Governments (COAG) Energy Council agreed the AEMC's future competition reviews should assess the state of retail competition across all jurisdictions within the national electricity market (NEM).¹ This includes Queensland, New South Wales, the Australian Capital Territory, Victoria, South Australia and Tasmania. The NEM-wide reviews are to be conducted on an annual basis.

The AEMC completed its first NEM-wide retail competition review in August 2014 and is required to complete the second review by 30 June 2015. All future reviews must be completed by 30 June each year.

1.1 Purpose of this Consultation paper

This is the first of two publications for consultation as part of the 2015 retail competition review. This document sets out the proposed assessment framework for the AEMC's 2015 review for stakeholder comment.

In this paper, we are proposing some changes to the information we collect for the 2015 review based on lessons learnt through conducting the first NEM-wide review. These issues are discussed in Chapter 3.

Information on how to make a submission on this consultation paper is provided in section 1.4 and the key issues for this first round of consultation are set out in Appendix A.

In December 2014, we will be publishing the second consultation document. This will be an approach paper which will confirm our assessment framework for the 2015 review and will ask for stakeholder submissions on the state of competition in NEM jurisdictions. Further detail on two consultation stages for this review is provided in section 1.3.

1.2 Scope of this review

Under the COAG Energy Council's standing terms of reference, the AEMC's annual reviews are to comment on issues affecting competition in retail electricity and gas

¹ The COAG Energy Council was previously the Standing Council on Energy and Resources.

markets across NEM jurisdictions.² The reviews are to report on the current state of retail competition and its possible future development.

We are required to focus on the small customer end of retail energy markets. The consumption thresholds used to define small customers vary across jurisdictions. We are permitted to use the relevant jurisdictional consumption thresholds or any other means the AEMC deems appropriate.³

The reviews are to principally cover jurisdictions that are subject to retail price regulation. For comparison purposes, the AEMC is required to also take into account the effectiveness of competition in jurisdictions where prices have been deregulated.

The terms of reference require the AEMC to consider a set of criteria in assessing the effectiveness of competition across and within NEM jurisdictions. This is subject to practicality, data availability and resource constraints. Consistent with the AEMC's approach for the 2014 retail competition review, we will use these criteria as a framework for our assessment of whether retail markets are competitive. This framework is depicted in Figure 1.1 below and discussed further in Chapter 3.

Figure 1.1 Competitive market indicators - assessment framework



The terms of reference also require the AEMC to advise Energy Ministers on whether we could usefully provide further advice to any jurisdictions on possible ways to transition to price deregulation. Following the completion of this review, there may be scope for the AEMC to provide more detailed advice on possible pricing reform for specific jurisdictions, as required.

² The terms of reference are available on the AEMC website: www.aemc.gov.au (project code: RPR0003).

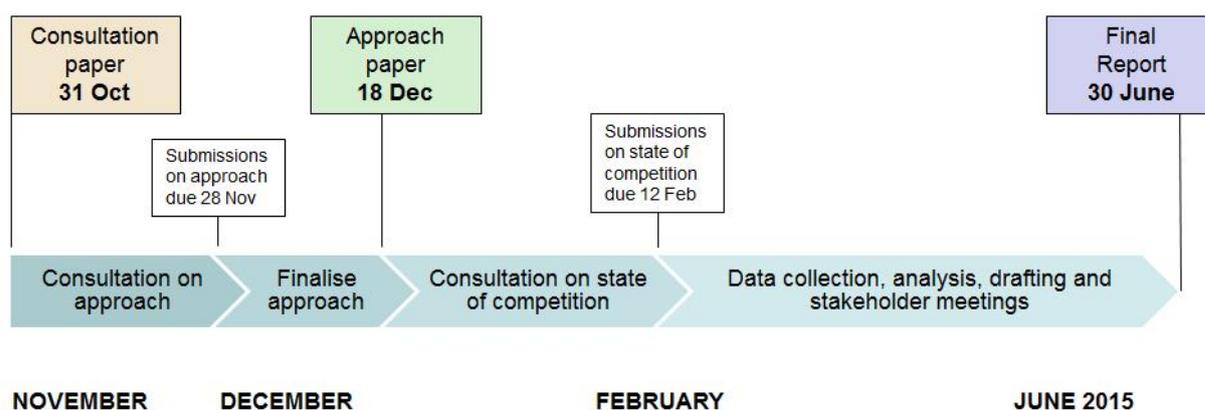
³ The jurisdictional definition for 'small customers' varies across the NEM, with annual consumption thresholds ranging from 100 to 160 MWh for electricity and generally less than 1 terajoule for natural gas.

1.3 Process for this review

The AEMC is required to consult with jurisdictions during the preparation of our report. The terms of reference state that the AEMC may also consider consultation with key stakeholders where practicable.

Stakeholder consultation will form a key component in the development of our findings and we will be consulting in two stages, as set out in Figure 1.2 below.

Figure 1.2 Process for the 2015 retail competition review



This consultation paper starts the first stage of consultation, where we are asking for stakeholder views on our assessment framework for the 2015 review. Submissions are requested by 28 November 2014.

Following submissions and discussions with stakeholders, we will start our second stage of consultation when the approach paper is published on 18 December 2014. The approach paper will confirm our assessment framework for the 2015 review and ask for stakeholder submissions on the state of competition in NEM jurisdictions. This second round of submissions will be requested by 12 February 2015.

In addition to these two formal consultation processes, we plan to hold discussions with stakeholders during the end of 2014 and the first half of 2015 to seek comments and request information. This will likely involve consumer groups, retailers, the Australian Energy Market Operator, the Australian Energy Regulator, jurisdictional regulators, Ombudsmen and jurisdictional governments.

We invite any stakeholders to contact the AEMC if interested in discussing any aspect of this review. Please contact Skye d'Almeida to arrange a discussion on (02) 8296 7800 or skye.dalmeida@aemc.gov.au.

1.4 Submissions

For this first stage of consultation, the AEMC is requesting submissions on our assessment framework for the 2015 review. The AEMC is particularly interested in stakeholder responses to questions set out in Attachment A. Stakeholders are invited to provide written submissions by **28 November 2014**.

All information will be treated in accordance with the AEMC's submissions guidelines which can be viewed at www.aemc.gov.au.

Submissions should refer to AEMC project number "RPR0003" and be sent electronically through the AEMC's online lodgement facility at www.aemc.gov.au. All submissions received during the course of the review will be published on the AEMC's website, subject to any claims of confidentiality.

In order for the review to be completed within the timeframe provided the AEMC must adhere to strict deadlines. While we will have full regard to all submissions lodged within the specified time period, late submissions may not be afforded the same level of consideration. To ensure the AEMC is able to fully consider all submissions, we request that stakeholders lodge their submissions by no later than the due date.

2 Background to this review

The AEMC is required to undertake competition reviews to provide advice to governments to support a commitment under the Australian Energy Market Agreement (AEMA). Under the AEMA, all jurisdictions have committed to remove retail energy price regulation where effective competition can be demonstrated. This recognises the importance of effective competition to promote the long-term interests of energy customers.

2.1 Retail energy market competition in NEM jurisdictions

Government regulation may influence the level of competition in any market. Regulation of energy retail markets in jurisdictions has changed over time to promote greater competition. These markets traditionally involved vertically integrated, government-owned monopolies. Jurisdictional regulation prohibited new energy retailers from entering the market and customers did not have a choice of energy retailer.

A series of energy market reforms began in the 1990s in recognition of the benefits that competition can offer to customers. Australian jurisdictions have adopted a staged approach to promote competition. A critical first step was to introduce retail contestability to allow customers to choose their retailer. Large and small customers are now permitted to choose their retailer of both electricity and gas in all NEM jurisdictions.

With the introduction of retail competition, jurisdictions sought to protect customers through regulatory mechanisms until competition was seen as effective. The regulatory mechanisms generally involved price regulation as well as obligations governing retailers' interactions with customers (such as information requirements).

2.1.1 Price regulation

Jurisdictions have recognised that when competition reaches a sufficient level, price regulation becomes unnecessary and can be detrimental. Victoria, South Australia and New South Wales achieved their AEMA commitment to remove retail electricity price regulation in 2009, 2013 and 2014, respectively, as these jurisdictions considered that their retail markets were sufficiently competitive. The Queensland Government intends to remove electricity price regulation in South East Queensland from 1 July 2015.⁴

Removal of price regulation does not mean the removal of all regulation. There are a series of customer protection measures that remain in place to provide support to small customers in jurisdictions where price regulation is removed. These include jurisdictional and national protection measures to support customer choice, govern the

⁴ Further information on the Queensland Government's plans is available at: <http://www.dews.qld.gov.au/policies-initiatives/electricity-sector-reform>

terms and conditions of contracts, provide a mechanism for complaint resolution and provide assistance to those in hardship.

3 Assessment framework for the 2015 review

This section sets out how we plan to conduct our assessment of competition in each NEM jurisdiction for the 2015 review.

We plan to adopt a similar approach to the 2014 review. This review will provide an opportunity to check whether there have been any significant changes in the competitiveness of the energy retail markets since the last review. The review may also explore additional retail competition issues if stakeholders identify issues of relevance to the review that were not considered in the 2014 analysis.

3.1 Stocktake of relevant projects

As part of this review, we plan to engage with other organisations undertaking work relevant to monitoring aspects of retail energy markets.

A number of organisations are assessing various indicators of competition in NEM jurisdictions. This includes work by government and regulatory bodies, as well as consumer groups and Ombudsmen. Some of these projects are repeated on an annual basis and cover similar issues to the AEMC's competition reviews. The projects undertaken by government and regulatory bodies that we consider to be most relevant to our review are summarised in Table 3.1 below.

Table 3.1 Government and regulatory projects of relevance to the AEMC retail competition review

Project	Responsible body	Scope	Timing of document
Residential electricity price trends report	Australian Energy Market Commission	Advice on the factors affecting residential electricity prices and possible future trends.	Published annually in Q4
Review of competition in Victoria's electricity retail market⁵	Victorian Government	Investigating possible steps to improve competition, with a focus on regulatory and market barriers; informational, economic, behavioural and demographic issues inhibiting consumer engagement; and addressing the possible existence and extent of retail electricity margins.	To be confirmed
Monitoring of the NSW retail electricity market⁶	NSW Independent Pricing and Regulatory Tribunal (IPART)	Monitoring the performance and competitiveness of the retail electricity market in NSW. The NSW Minister may also ask IPART at any time to carry out a special review of prices and profit margins.	Annual report provided to NSW Energy Minister in Q4 each year

⁵ Victorian Government, *Victoria's Energy Statement*, Victorian Department of State Development, Business and Innovation, October 2014, p18.

⁶ New South Wales National Energy Retail Law (Adoption) Amendment (Retail Price Deregulation) Regulation 2014

Project	Responsible body	Scope	Timing of document
Energy retail prices in SA: Ministerial pricing report⁷	Essential Services Commission of South Australia	Reporting on electricity and gas standing and market offer prices that were generally available to small customers in the previous financial year.	Annual report provided to the Minister for Mineral Resources and Energy and published in Q3
Market monitoring in South East Queensland⁸	Queensland Competition Authority (QCA)	Retail electricity market monitoring, reporting and review in South East Queensland.	To be confirmed. Annual report with first publication expected in 2016.
Retail energy market performance reporting⁹	AER	Monitoring retailer performance in NECF jurisdictions on a range of indicators including: customer numbers; contract types; complaints; energy debt; payment plans; hardship programs; disconnections and reconnections.	Quarterly updates and a report published annually in Q4
State of the Energy Market¹⁰	AER	Monitoring retailer performance in NECF jurisdictions on a range of indicators including: customer numbers; contract types; complaints; energy debt; payment plans; hardship programs; and disconnections and reconnections.	Quarterly updates and a report published annually in Q4
Energy retailers comparative performance report- pricing¹¹	Essential Services Commission of Victoria	Reporting on standing offer and market offer prices in Victoria.	Published annually in Q3
Comparison of Australian Standing Offer Energy Prices¹²	Office of the Tasmanian Energy Regulator (OTTER)	A comparison of electricity and gas standing offer prices in each jurisdiction.	Report updated every 6 months, published in Q1 and Q3 each year

⁷ Essential Services Commission of South Australia 2014, ESCOSA, Adelaide, viewed 15 October 2014, <<http://www.escosa.sa.gov.au/article/newsdetail.aspx?p=16&id=1283>>

⁸ Queensland Electricity Competition and Protection Legislation Amendment Act 2014

⁹ Australian Energy Regulator 2013, AER, viewed 15 October 2014, <<http://www.aer.gov.au/node/22827>>

¹⁰ Australian Energy Regulator 2013, AER, viewed 15 October 2014, <<http://www.aer.gov.au/node/23147>>

¹¹ Essential Services Commission 2012, *Energy retailers comparative performance report – pricing 2011-12*, September

¹² Office of the Tasmanian Economic Regulator 2014, OTTER, viewed 15 October 2014, <<http://www.energyregulator.tas.gov.au/domino/otter.nsf/8f46477f11c891c7ca256c4b001b41f2/db69ef3e7e82500fca2575d60007ebb9?OpenDocument>>

While the scope of these projects differs to the AEMC's retail competition review, there is considerable overlap in the issues considered and data collected. We will be seeking to work with a number of organisations to leverage existing work and minimise duplication across organisations in order to maximise the value of the AEMC's annual reviews.

Over the medium term, we expect there is benefit in ongoing monitoring of competition in all NEM jurisdictions. However, as competition develops further over the longer term, the scope and timing of this range of work may warrant consideration.

3.2 Differences between the 2014 and 2015 approach

The AEMC is proposing ways to refine our approach in recognition of the shorter timeframe available for the 2015 review, the work of other organisations, and drawing on our experience in conducting our first NEM-wide review.¹³

The AEMC plans to conduct this review in a way that is broadly consistent with the 2014 review. For the 2015 review, we will assess the same competitive market indicators in each jurisdiction and identify ways to improve the competitiveness of retail markets, consistent with the terms of reference. However, we are proposing some changes to the information we collect to focus on areas of most value.

The key changes proposed for the 2015 review relate to elements of the consumer and retailer research and we do not expect these changes to have a material impact on the quality or rigour of the findings. This approach reflects the low likelihood that particular market characteristics will materially change over a twelve month period and extensive qualitative research for those indicators may not be warranted every year.

3.2.1 Consumer research

The AEMC engaged Newgate Research to conduct quantitative and qualitative research on small electricity and gas customers' experiences of retail energy markets in the NEM in 2014.

A quantitative survey was conducted with 1,833 residential customers and 380 small business customers across South East Queensland, New South Wales, the Australian Capital Territory, Victoria and South Australia.

This survey was complemented with a series of qualitative forums held in the capital city and a regional centre in South East Queensland, Victoria and South Australia, as well as Canberra. Each forum lasted for approximately 3.5 hours and comprised between 14 and 32 participants, with a total of 162 participating in forums.

¹³ For the 2014 review, the COAG Energy Council agreed to extend the time frame for the final report to be published by 1 September 2014. For the 2015 review, we will have two months less time as we are required to publish the report by 30 June 2015.

We intend to repeat the customer survey which offered the most valuable insights for the 2014 review. We will consider the need to supplement the survey findings with qualitative forums where there is a need to understand particular issues in further depth. Future reviews could include qualitative customer research to periodically update the findings of previous reviews and explore new topics around promoting consumer engagement in retail markets.

We plan to adopt a similar format to 2014 for the customer surveys. The demographic profile of survey respondents and a list of the questions asked in 2014 are set out in the appendices of the Newgate Research report, available on our website.¹⁴

In developing the 2015 survey, we plan to repeat a number of questions to track trends in responses over time and may replace some questions with alternatives based on stakeholder feedback and our assessment of key issues for 2015.

3.2.2 Retailer research

For the 2014 review, the AEMC engaged consultants to conduct interviews with energy retailers to elicit their views and experiences in operating in energy markets across the NEM. Retailers were also given the option to respond to a survey. A total of 14 retailers agreed to be interviewed, 13 agreed to complete the electricity survey and seven completed the gas survey.

For the 2015 review, we do not intend to repeat the interview process. Instead, we plan to use a retailer survey to determine whether there have been any key changes in retailers' views and experiences in operating in energy markets since the last review. This may then be followed up with interviews with retailers if further detail would be informative. We consider that this information will be sufficient to understand any key changes in retailers' views since 2014. The survey results will also allow us to track any trends in retailer responses.

We are not planning to collect data from retailers for the purpose of the competition review. Retailer participation in data collection for the 2014 review was mixed and some of the retailers that participated were not able to provide information on all issues. In some instances retailers' systems did not allow them to extract the information we requested and they instead provided an estimate. Consequently, while the information provided was considered in our analysis, we did not rely on it to draw conclusions for the 2014 review.

Consistent with 2014, we will be looking to work with the Australian Energy Regulator and other organisations to draw from the relevant non-confidential retailer information they collect. We also welcome any data that retailers would like to provide us to assist our consideration of the state of competition in each NEM jurisdiction.

¹⁴ This is available on the project page for the 2013 Retail Competition Review on the AEMC website: www.aemc.gov.au (project code: RPR0002)

3.3 Data time frames

It is important for any assessment of competition to look over a period of time. Competition is a process and conclusions on its effectiveness cannot be based on a single point in time. We will look at a range of competitive indicators across the 2014 calendar year and will take historical data into account, subject to data availability.

It is also important to consider whether current conditions are likely to prevail in the future. As part of this assessment, we will ask whether there are likely to be any major changes in market conditions that could impact the level of competition in the future.

3.4 Market definition

We are proposing to adopt the same market definition for this review as for the 2014 review, which was supported by the available data.

We propose to consider each jurisdiction as a single geographic market with two product markets: an electricity retail market and a gas retail market. We will also treat all small customers as part of the same market. There will be no distinction made between small business and residential customers.

A key exception to the above approach applies to Queensland, where we will look at two geographic markets. The first is South East Queensland, where customers can choose their retailer. The second is the remainder of Queensland, where retail competition is currently permitted but there is only one retailer at present.

Our market definitions may be subject to change if the data gathered during the review supports an alternative approach. In particular, we will analyse regional areas separately in each state to determine whether there are any systemic differences from urban areas.

3.5 Competitive market indicators

We have drawn on the criteria in the terms of reference and refined them to focus our assessment of whether outcomes in retail markets in NEM jurisdictions are consistent with effective competition. As discussed in Chapter 1, the competitive market indicators to be used for our assessment in this review are consistent with those that were used for the 2014 review. They are:

- 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
- whether retail energy prices are consistent with a competitive market.

Analysis of the first three indicators will help to provide a picture of the market structure and market conduct for each jurisdiction. The last two indicators should provide information on the performance of the market. The methods we plan to use to analyse these indicators are outlined below. This is not exhaustive and we may take other information into consideration during the course of the review.

3.5.1 Customer activity in the market

A desirable outcome of a competitive market is that customers are aware of the choices available to them and are able to act on those choices. By shopping around to receive lower prices or better service, customers play an important role in maintaining downward pressure on prices and driving retailers to provide the quality of service customers demand. Customer activity is an important indicator of whether competition is effective. Our analysis of this market indicator will consider:

- *customer engagement in choosing market offers* to see what proportion of customers are on market offers and what proportion are on standing or regulated offers;
- *customer attitudes* obtained through surveys to understand how and why customers participate in the market and whether there are issues preventing customers from shopping around; and
- *customer switching* showing the number of people switching retailer. These will be carefully interpreted in conjunction with other indicators as we note that high or low switching rates are not necessarily a sign of a well-functioning market.

3.5.2 Barriers to entry, exit or expansion

Identifying any significant barriers to entry, expansion and exit is an important element of an assessment of competition. This involves analysing whether new retailers can freely enter the market and whether incumbent retailers can exit or expand within the market. Under these conditions, there are competitive pressures on existing retailers to charge prices commensurate with efficient costs and improve their offers. An effectively competitive market will generally have no significant barriers to entry, exit or expansion. Our analysis of this market indicator will consider:

- *evidence of entry, exit or expansion* and whether this is indicative of low barriers to entry, exit or expansion for that market;
- *retailer surveys* to understand the difficulties that retailers may encounter in entering or expanding in a market. This could include economies of scope or scale, accessing and transporting gas, and regulatory barriers such as prudential requirements and state-based regulatory costs and obligations; and
- *measures of contract market liquidity* as a test of whether new entrant retailers are able to obtain hedging products to manage their risk exposure.

3.5.3 Independent rivalry

Independent rivalry reflects the extent to which retailers are competing to attract or retain customers. Rivalry between retailers helps to drive discounting and product innovation. An effectively competitive market will generally have a high level of independent rivalry.

Our analysis of this market indicator will consider:

- *market share and concentration*, and how these have changed over time;
- *switching* between the big three retailers¹⁵ and switching between the big three and smaller retailers. This is to test whether retailers are actively attracting new customers and whether smaller retailers are able to gain or maintain market share; and
- *product differentiation and the number of market offers available* to test whether retailers are competing by offering different products and services that meet the needs of their customers.

3.5.4 Customer outcomes

High levels of customer awareness and high switching rates by themselves do not provide a full picture of whether there is competition in a market. In effectively competitive markets, customers are generally satisfied with the range of products available to them and the choices that they make. Our analysis of this market indicator will consider:

- *customer complaints* to test customer satisfaction with market outcomes; and
- *customer surveys* to test customer satisfaction with the choices available and level of service provided.

3.5.5 Competitive retail prices

Retail prices can be expected to fluctuate with changes in underlying costs, changes in the behaviour of competitors and in response to customer behaviour. Trends in retail prices over time can provide an indication of the level of competition in a market. Our analysis of this market indicator will consider:

- *historic prices* charged by retailers in NEM jurisdictions;
- *the composition of these prices*; and
- any evidence to evaluate the effectiveness of competition in the market with respect to price.

¹⁵ The “big three retailers” refers to the three energy retailers with the highest market shares across the NEM jurisdictions, which are AGL, EnergyAustralia and Origin Energy.

A Questions for stakeholder submissions

For this first round of consultation, the AEMC is seeking stakeholder views on the proposed assessment framework for the 2015 review. Details on how to provide a submission are set out in section 1.4. A second round of consultation will occur from mid-December 2014 to mid-February 2015 where we will be seeking submissions on the state of competition.

Assessment framework for the 2015 review

1. Will the framework set out in section 3 of this paper enable the AEMC to adequately assess the state of competition in NEM jurisdictions?
2. Which elements of the 2014 review were of most value that you would like to see repeated in the 2015 review, noting the scope of similar work being undertaken by other organisations?
3. Were there any issues not considered in the 2014 review that you would like the AEMC to consider in the 2015 review that are within the scope of the terms of reference?