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Marking the market:

PIAC submission to the AEMC's Issues Paper – *Review of Competition in the Retail Electricity and Natural Gas Markets in NSW*

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1. Introduction

The Public Interest Advocacy Centre

The Public Interest Advocacy Centre (PIAC) is an independent, non-profit law and policy organisation that works for a fair, just and democratic society, empowering citizens, consumers and communities by taking strategic action on public interest issues.

PIAC identifies public interest issues and, where possible and appropriate, works co-operatively with other organisations to advocate for individuals and groups affected. PIAC seeks to:

- expose and redress unjust or unsafe practices, deficient laws or policies;
- promote accountable, transparent and responsive government;
- encourage, influence and inform public debate on issues affecting legal and democratic rights; and
- promote the development of law that reflects the public interest;
- develop and assist community organisations with a public interest focus to pursue the interests of the communities they represent;
- develop models to respond to unmet legal need; and
- maintain an effective and sustainable organisation.

Established in July 1982 as an initiative of the (then) Law Foundation of New South Wales, with support from the NSW Legal Aid Commission, PIAC was the first, and remains the only broadly based public interest legal centre in Australia. Financial support for PIAC comes primarily from the NSW Public Purpose Fund and the Commonwealth and State Community Legal Services Program. PIAC also receives funding from the Trade and Investment, Regional Infrastructure and Services NSW for its work on energy and water, and from Allens for its Indigenous Justice Program. PIAC also generates income from project and case grants, seminars, consultancy fees, donations and recovery of costs in legal actions.

Energy + Water Consumers' Advocacy Program

This Program was established at PIAC as the Utilities Consumers' Advocacy Program in 1998 with NSW Government funding. The aim of the program is to develop policy and advocate in the interests of low-income and other residential consumers in the NSW energy and water markets. PIAC receives policy input to the program from a community-based reference group whose members include:

- Council of Social Service of NSW (NCOSS);
- Combined Pensioners and Superannuants Association of NSW;
- Park and Village Service;
- Ethnic Communities Council NSW;
- Rural and remote consumers;
- Retirement Villages Residents Association;
- Physical Disability Council NSW; and
- Affiliated Residential Park Residents Association.

2. The current review

PIAC thanks the Australian Energy Market Commission (AEMC) for the opportunity to provide comment on its Issues Paper, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales* (the review). Under the Australian Energy Market Agreement, an AEMC review of the effectiveness of competition is the first step in the process of removing price deregulation.[1]

At this early stage of the of the review process, PIAC is keeping an open mind in terms of deregulation of electricity retail prices in the AusGrid and Endeavour Energy network areas. PIAC intends to assess other responses to the review, the AEMC's customer and retailer surveys, and other relevant material to inform our final position. PIAC notes, however, that there are regulatory, customer protection, consumer information and implementation issues that would need to be resolved in order to secure a successful transition to a deregulated electricity market that benefits a wide variety of NSW residential consumers.

In relation to Essential Energy's network area, PIAC's position is that competition is not sufficient for price regulation to be removed. More reforms to promote competition need to be implemented, followed by another assessment of their effectiveness before price deregulation can properly take place. Research commissioned by PIAC, published in the report *Choice? What Choice?,* showed that consumers in the regional centres of NSW that were the focus of PIAC's report are exposed to much lower levels of competition that their counterparts in greater Sydney and surrounding areas.[2]

Similarly, in terms of the gas retail market, PIAC does not believe customers would benefit from price deregulation at this stage. Although gas is often considered as secondary compared to electricity and as a fuel that households can elect to use or not, PIAC takes the view that it would be wrong to deregulate a market that does not show signs of strong competition based on the reasoning that it is a less important service. For many households, gas is an important fuel source. This is especially true in colder regions where gas is used for heating purposes. Similarly, those living in rental properties have little scope to change their stove or hot water from gas to electricity. PIAC also submits that it would be wrong to deregulate the retail gas market, where effective competition does not exist, simply for the sake of doing so at the same time as electricity. Finally, the significant investment required to change appliances to use an alternative fuel source must be considered. For many households, including most tenants, the cost of changing from gas heating/cooking to electric heating/cooking would be prohibitive.

The remainder of this submission addresses the broader topics and some of the more specific questions set out by the AEMC in its Issues Paper. This submission addresses our views and concerns in relation to market definition, market structure, market conduct, market performance, customer access to the benefits of competition, and options and pathways for the removal of price deregulation if the NSW Government so chooses. Where relevant, we have drawn upon experiences and lessons from other jurisdictions, with particular reference to Victoria, where prices have been deregulated for five years.

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1 Council of Australian Governments, *Australian Energy market Agreement* (2004), 28.
2 Schetzer, L, *Choice? What Choice?*, (2011), Sydney: PIAC.

This submission also includes a number of recommendations regarding issues that PIAC would like to see the AEMC examine as part of this review and recommendations on issues relating to the possible transition to retail electricity and gas markets without price deregulation. These include:

- a separate examination of competition in each of the three electricity network areas;
- investigating the rate at which consumers change their gas supplier without changing their electricity supplier;
- investigating the impact of late-payment fees on the effectiveness of competition;
- a ban on all early termination fees;
- no gradual roll-back of price regulation in line with consumption thresholds;
- price deregulation to only occur after a comprehensive consumer information campaign has been undertaken and independently assessed as having been effective; and
- the NSW Government to retain the power to easily re-regulate prices if competition becomes ineffective in NSW retail gas and electricity markets.

3. Market definition

PIAC welcomes the AEMC's aim to consider the question of market definition ahead of this competition review. However, given one purpose of the review is to identify pathways for the removal of retail price regulation, the scope of retail price deregulation must also be clarified. What is meant by 'retail prices'? Are connection, disconnection, late payment, and exit fees included in the 'retail price package'? Is the setting of tariff shapes viewed as a task that should be conducted by those who set the price?

PIAC believes that this is an additional aspect of retail price deregulation that needs to be discussed as part of this review. It may be that that complete deregulation is appropriate for setting of price (ie, cents per kWh), but with a regulatory framework still playing a key role in allowing or approving fees as well as determining tariff shapes.

When discussing deregulation of retail energy prices it is important to distinguish between price setting (ie, cents per kWh/Mj or per day for the supply charge) and determining a retail tariff shape. Tariff shapes become increasingly important given the likely growth of time of use (TOU) pricing in coming years. In deregulated Victoria, the preparation for lifting the ban on TOU pricing from July 2013 included lengthy consultation through which it was agreed to commence the TOU pricing regime with a government negotiated network tariff structure in place for the first 12 months.

To enable TOU pricing, it is necessary for consumers to have smart meters installed. The recent *Discussion Paper* by the NSW Smart Meter Task Force states:

> It may be argued that the greatest benefit of smart meters is the possibility of reducing electricity consumption (particularly peak consumption) to avoid spending more on generators and networks. Smart meters have the potential to assist in this regard by encouraging customers to change when and how they use energy through price signals.[3]

[3] NSW Government, *NSW Smart Meter Task Force Discussion Paper* (2012), 11

However, looking at the regulated TOU rates in the AusGrid network area shows that the fixed supply charge increased by 120% from 2008 to 2012 (see chart 1 and 2 below), which does nothing to encourage customers to change when and how they use energy. By comparison, the off-peak charges increased by 116%, the shoulder rates by 96% and the peak charges by 74% over the same period. PIAC believes that it is important to understand the additional risk TOU pricing can bring to both network and retail operations, and that these risks are kept at the forefront in discussions about what TOU pricing can and should achieve, ie, reduce peak demand and give consumers more control over their energy costs.

The substantial increase in fixed charges is arguably a way for industry to hedge against reduced revenue from consumers responding to time varying prices. While that may still reduce peak demand, high fixed charges also limit consumers' ability to take control over their electricity costs. In theory, competitive pressures should ensure that retailers do not simply increase their fixed supply charge when offering TOU tariffs. However, PIAC remains concerned that an electricity market characterised by such high levels of market concentration (shared by three retailers – see section 4.1 below) may not be competitive enough to prevent these outcomes. This concern is exacerbated by the fact that TOU pricing involves increased retail risk that the three largest retailers are best equipped to deal with (due to their large customer portfolios).

Chart 1 – Regulated TOU tariff in AusGrid's network area from 2008-2012

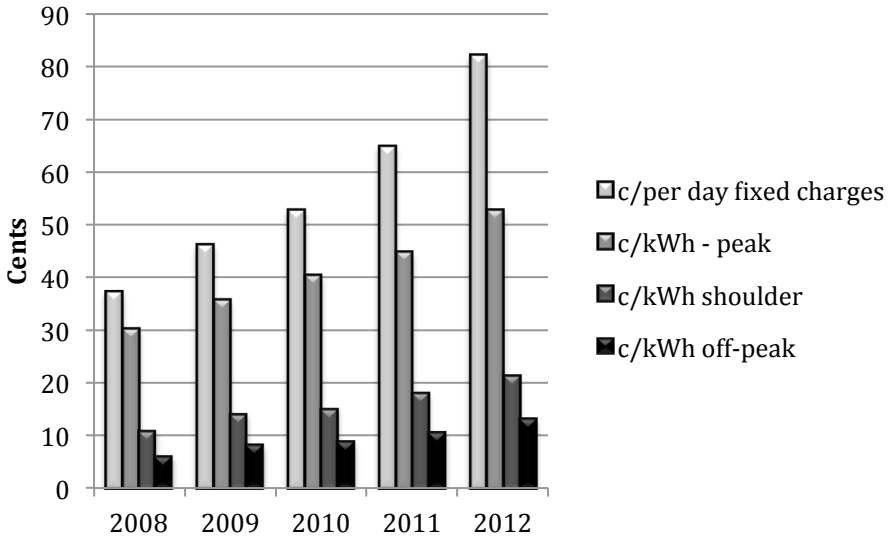
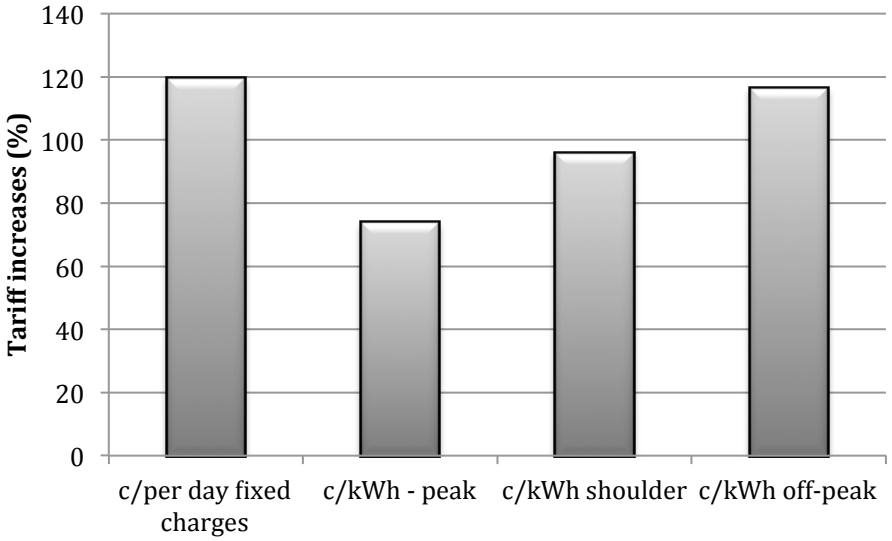


Chart 2 – Percentage increases to the various component of the regulated TOU tariff in AusGrid's network area from 2008–2012



In relation to TOU pricing and smart meters, PIAC recommends that the responsible regulator develop a thorough market monitoring process (the responsible regulator is currently the NSW Independent Pricing and Regulatory Tribunal (IPART) but will become the Australian Energy Regulator (AER) when NSW implements the National Energy Consumer Framework (NECF)). This monitoring must include analysis of TOU tariff developments as well as customers' ease of switching retailers in a smart meter environment.

While PIAC understands that the current proposals by the AEMC's *Power of Choice* review is to introduce competition in metering services and to improve the ease with which consumers switch retailers[4], PIAC nonetheless believes a prudent safeguard would be to monitor these issues closely to ensure that potential negative developments can be promptly acted upon.[5]

Recommendation 1

PIAC recommends that the responsible regulator develop a process for monitoring TOU tariff developments in NSW as smart meters are introduced, and be equipped to promptly act upon any negative trends for residential consumers that may emerge.

In relation to some of the more specific questions on market definition raised in the Issues Paper, PIAC wishes to make the following comments.

3.1 Consumption levels and cost to serve

Higher consumption customers are generally more profitable to retailers compared to low consumption customers. PIAC, therefore, understands retailers' preference for higher consumption customers and scenarios. To date, the value of market share and varied customer portfolios seems to be more important to retailers as a way to minimise risk. At the same time, higher fixed charges make lower consumption customers more profitable and can therefore be

4 AEMC, *Power of Choice review – Final Report* (2012).
5 Ibid 82.

a tool for new or small retailers to manage risk. PIAC submits that in a competitive market, large retailers should be able to use their customer portfolio to manage such risk, rather than increasing fixed charges.

Increasing fixed charges is one reason PIAC does not support a gradual deregulation process based on consumption thresholds. Retailers cannot know with certainty what the consumption of prospective customers will be (although this might change with smart meter technology) and it would thus be difficult to 'red-line' customers based on consumption level.[6] If, however, the AEMC decided to recommend a staged deregulation process based on consumption levels, the unintended consequence could be that retailers offered their best rates to the higher consumption users and made less-generous offers to the 'last group standing' in the price deregulation process. PIAC believes a gradual deregulation process based on consumption levels can erode the benefits of competition for average consumption households in NSW. The issue of the transition to price deregulation is discussed further in Section 7.2.

3.2 Consumption levels and barriers to supply

PIAC is not aware of any barriers to retailers supplying electricity to small customers at different energy consumption levels in NSW. PIAC does not believe that it is the consumption level per se that causes barriers to supply or competition. In recent times, the retail electricity market has largely focused on sales, acquisitions and customer numbers, rather than consumption levels. These have been taken as a key driver—and measure—of competitive behaviour.

In terms of gas, PIAC submits the low volumes required by small customers in NSW (due to low penetration as well as relatively low average consumption) may cause a barrier to new suppliers entering the market, but not necessarily a barrier to supply.

3.3 Geographic locations and cost of supply

It is more expensive to serve customers in Essential Energy's network area than customers in Ausgrid's or Endeavour's respective network areas, due to the large geographical are and low customer density of the former. These costs are reflected in the network charges and passed on to the relevant customers.

PIAC argues that the additional costs that retailers face in rural areas are more related to customer acquisition than the cost of supply. It should also be noted that the additional cost of acquisition can have a major impact on competition. As long as door-to-door marketing is the marketing approach of choice amongst retailers, PIAC anticipates customers in rural areas are less likely to benefit from competition.

3.3.1 PIAC's research into the experience of competition in regional centres

In June 2011, PIAC published the report *Choice? What Choice.* The report investigated the experience of the competitive retail market consumers in five NSW regional centres. PIAC commissioned the report in preparation for the AEMC's review of the effectiveness of competition in NSW.

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6 'Redlining' refers to the potential industry strategy of avoiding or encouraging low-return customers to move to another supplier. See, for example, Sharam A., *From Universal Service to No Service?: The Redlining of Vulnerable Electricity Customers in Victoria* (2001), Melbourne: Victorian Council of Social Service.

Choice? What Choice? found that customers in the five regional centres surveyed (Cooma, Bourke, Wagga Wagga, Lismore and Orange) experienced lower levels of contact from retailers than their counterparts in greater Sydney, the Illawarra and Hunter. Between 35% and 49% of respondents indicated that they had been approached by a retailer with an offer to sell them electricity.[7] This was significantly less than the 73% of respondents in Victoria (in 2007) and 68% in South Australia (in 2008).[8]

The report also found that consumers in the areas surveyed had a lower level of awareness of the competitive market than their counterparts in greater Sydney, the Illawarra and Hunter. Between 63% and 82% of respondents to the *Choice? What Choice?* survey knew they had a choice of retailer in 2010[9], compared to 92% in Sydney (in 2006) and 90% in the Hunter and Central Coast (in 2008).[10] These figures regarding the awareness of choice of retailer are particularly concerning given that 'effective participation requires consumers to have a sufficient level of awareness of alternatives to enable them to make an informed choice as to which option will be most advantageous to them'.[11]

In light of the survey results, the report concludes that there is 'insufficient evidence that effective competition currently exists in the electricity markets in these regions'.[12] In light of this finding, PIAC recommends that the AEMC undertake a specific assessment of the effectiveness of competition in the Essential Energy network area, along with the other two network areas of NSW. PIAC believes that differences in customer density, network charges and marketability are more important for retail competition than whether the customer consumes kWh below or above an artificially created threshold.

A copy of *Choice? What Choice?* is at Appendix 1 to this submission.

Recommendation 2

PIAC recommends that the AEMC undertake a separate examination of the effectiveness of competition in each of the three NSW distribution areas.

4. Market structure

PIAC sees five key structural barriers to effective competition in NSW residential retail and gas markets:

1. extremely high market concentration among a small group of retailers, following the sale of energy retail operations in 2011;
2. issues pertaining to obsolete legacy tariffs in the Essential Energy network area;
3. the regulatory framework allowing additional fees and charges such as late payment fees, exit fees and connection fees, which leads to retailers to become overly reliant on revenue from non-energy related charges;

7 Schetzer, above n 2, 45.
8 Ibid 41.
9 Ibid 36.
10 Ibid 35.
11 Ibid 72.
12 Ibid 4.

4. the retail price setting process, which involves a single regulated tariff (per metering type) for each network area. This model means that there has been very little tariff and product innovation in NSW over the last few years; and
5. the gas wholesale market arrangements.

4.1 Increased market share concentration

As previously stated, the sale of the former state-owned energy retailers has led to an increased concentration of suppliers in the retail electricity market. Prior to the sale in March 2011, the three state-owned retailers had a combined market share of 79%. Those three companies in their privatised form now account for 95% of the NSW retail residential market.[13] This means that the current NSW market concentration is nearly as high as it was in Victoria in 2004, two years after the introduction of full retail competition, when the Essential Services Commission Victoria reported that the three previously state-owned retailers had a market share of 97%.[14] By the time the AEMC commenced the competition review for the Victorian retail markets, however, the incumbents' market share had fallen to 80% (and 88% for the gas retail market).[15]

PIAC is concerned about the high concentration of market share and the potential impact it could have on a deregulated retail market. Research from Victoria shows that four years after deregulation the three retailers continue to hold approximately 80% of the residential electricity market and 85% of the residential gas market.[16] Clearly, a long-term three-firm concentration ratio of 95% (electricity) and 98% (gas) would be an undesirable outcome for NSW energy customers if retailers were to determine retail prices while possessing the market power that comes with such a high concentration of market share.

4.1.1 Service standards and obligations under price deregulation

PIAC is also concerned that the increasing market share of a small group of retailers is allowing them to reduce the access to non-price services they offer to their customers. In particular, PIAC notes that according to the NSW Independent Pricing and Regulatory Tribunal (IPART), the use of Centrepay decreased by 22% in 2011/12, despite an increase in residential disconnections from 18,561 to 23,207.[17]

PIAC submits that if price regulation is to be removed in NSW, retailers should continue to be subject to service standards, including those surrounding customer assistance to hardship customers. If consumers lose the protection of a regulated price for electricity and gas, it will become even more important that they retain some protection in the form of strong regulation in other areas of service provision. A crucial part of maintaining service standards in the absence of a regulated price is also ensuring that regulatory agencies have sufficient resources to ensure that retailers are complying with their obligations to customers.

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13 IPART, *Electricity retail businesses' performance against customer service indicators in NSW, For the period 1 July 2006 to 30 June 2010* (2011), 5; AEMC, *Review of Competition in the Retail Electricity and Natural Gas Markets in NSW – Issues Paper* (2012), 21.

14 See for example, AEMC, *Review of the Effectiveness of Competition in Gas and Electricity Markets in Victoria – Issues Paper* (2007), 17.

15 AEMC, *Review of the Effectiveness of Competition in Gas and Electricity Markets in Victoria – First Final Report* (2007), 33.

16 CUAC, *Market Power in the Victorian Retail Energy Market* (2012), 6.

17 IPART, *Customer service performance of electricity retail suppliers: 1 July 2007 to 30 June 2012*, (2012), 8, 15.

Recommendation 3

PIAC recommends that if energy prices are deregulated, retailers should continue to be subject to service standards and obligations, including in relation to hardship customers and offering Centrepay as a payment option to all eligible customers.

4.2 Obsolete tariffs

PIAC believes that the numerous obsolete tariffs that a significant number of households in Essential Energy's network area are on pose an issue for the effectiveness of retail competition. Although the number of customers on these obsolete tariffs is decreasing (customers are moved off the tariff as they move home), there appears to be approximately 20% of customers in Essential Energy's network area still on these tariffs. PIAC's understanding is that the majority of these customers are concentrated in particular regions within the network area.[18]

From a retailer marketing perspective, these tariffs create a major obstacle to effective competition. Why would any retailer, small or large, spend resources on marketing in remote areas with low customer density without knowing (more or less) what the consumers are paying for their electricity and whether they can actually offer a better deal? As discussed elsewhere in this submission, price is clearly the number one reason that motivates customers to switch retailer and if a retailer does not even know whether their products beat current prices, signing up new customers would be a very difficult task.

The obsolete tariffs, combined with the rural location of the network, make the Essential Energy network less attractive as an electricity retail market. While this does not create a barrier to entry as such, it does create a barrier to active marketing by retailers and thus levels of competition. Other customers in Essential Energy's network area (ie, those on the non-obsolete tariffs) are paying the highest electricity prices in the state so the reluctance of those on obsolete tariffs to move to standard regulated rates or other market offers is easy to understand.

Table 1, below, shows the standard regulated retail tariff (all areas) and some of the obsolete area-specific tariffs available in Country/Essential Energy's network in 2011.[19] The table also includes an estimated annual bill calculation for households on the various tariffs (based on an annual consumption of 8000kWh per annum with no off-peak load).

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18 It is difficult to find exact numbers on the number of customers on the various obsolete tariffs. The 20% figure is from Mauseth Johnson, M, *NSW Energy prices July 2009- July 2011* (2011), Sydney: St Vincetn De Paul Society, 19.

19 These are some of the tariffs listed in: Country Energy Regulated retail price list, Effective 1 July 2011, Version 1. Note that this is just a sample of some of the tariffs available in the Essential Energy network area and have been included here to illustrate the level of tariff differentiation.

Table 1: Selected tariffs in the Essential Energy distribution zone.

Tariff	Description	Rates	Annual bill calculations
5700	Regulated tariff available in all areas	Peak: 28.8508 c/kWh Supply charge: 107.8044 c/day	Usage: $2,308 Supply charge: $393 Annual bill: $2,701
5000	Flat rate with lower supply charge	Peak: 28.8508 c/kWh Supply charge: 72.2777 c/day	Usage: $2,308 Supply charge: $264 Annual bill: $2,572
5504	Declining block with high consumption threshold and high supply charge	Peak: 28.8508 c/kWh (first 9.84kWh) Balance: 27.3944 c/kWh Supply charge: 107.8044 c/day	Peak usage: $1,039 Balance usage: $1,205 Supply charge: $393 Annual bill: $2,637
145	Declining block with low consumption threshold, big step change and lower supply charge	Peak: 37.1591 c/kWh (first 3.3kWh) Balance: 28.8508 c/kWh Supply charge: 72.2777c/day	Peak usage: $446 Balance usage: $1,962 Supply charge: $264 Annual bill: $2,672
140	Declining block with low consumption threshold, big step change and lower supply charge	Peak: 42.0563 c/kWh (first 3.28kWh) Balance: 27.6144 c/kWh Supply charge: 72.2777c/day	Peak usage: $505 Balance usage: $1,878 Supply charge: $264 Annual bill: $2,647
367	Flat rate with high supply charge	Peak: 28.8508 c/kWh Supply charge: 127.2491 c/day	Usage: $2,308 Supply charge: $464 Annual bill: $2,772
156	Declining block with low consumption threshold and low step change	Peak: 32.3356 c/kWh (first 3.28kWh) Balance: 28.8508 c/kWh Supply charge: 72.2777c/day	Peak usage: $388 Balance usage: $1,962 Supply charge: $264 Annual bill: $2,614

We have assumed that consumption blocks are daily thresholds (i.e. first 3.3 kWh/day = first 1200 kWh/annum, first 9.84 kWh/day = first 3600 kWh/annum etc.) although the Country Energy tariff document does not specify

Table 1 shows that there is significant variance between the different tariffs. Although the difference to annual bills is relatively low ($130 between tariff 5700 and tariff 5000) it must be remembered that the savings to individual households can be significantly higher (depending on their consumption level/pattern). Many of the obsolete tariffs have lower supply charges than tariff 5700 and can thus benefit low consumption households, while tariffs such as 145 can be beneficial to households with very high consumption.

PIAC recommends that the AEMC thoroughly investigate the issue of obsolete tariffs in Essential Energy's area (and to a lesser degree in Endeavour Energy's network area) during this review. The investigation should include whether the relevant retailer, Origin Energy, has a plan in place to address this issue. Further, as there is a lack of public information available about these tariffs, the AEMC's investigation should include options and pathways for how customers can be moved off obsolete tariffs without experiencing energy hardship or price shocks. While some households may have benefited from these tariffs, it is important to realise that a sudden change to electricity rates can cause problems for many household budgets. PIAC would not support a strategy to promote competition at the cost of hardship for individual households.

Recommendation 4

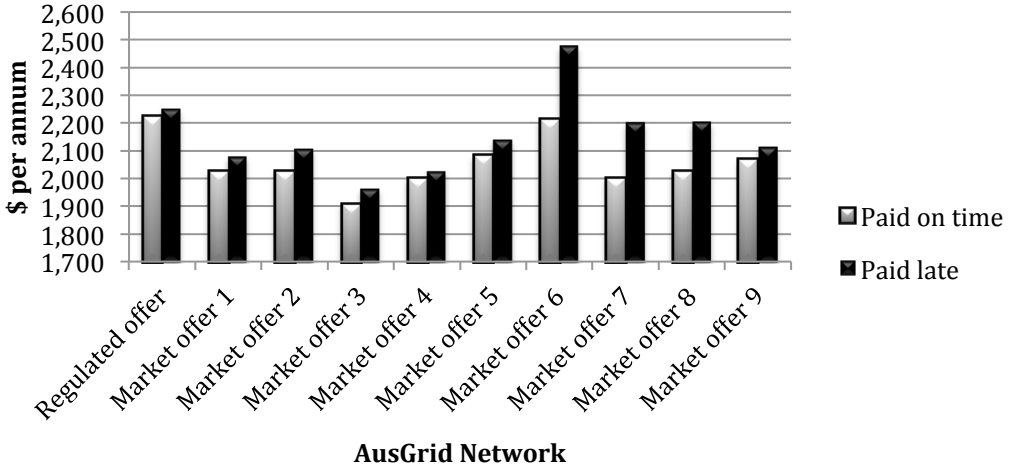
PIAC recommends that the AEMC investigate the issue of obsolete tariffs in some parts of NSW as part of this review. This investigation should include developing proposals to ease the transition of those customers off these tariffs in the event of price deregulation, to help reduce the price increases that these customers may experience.

4.3 The regulatory framework

To ensure that consumers can benefit from competition, it is important to create a minimum risk environment that allows them to confidently switch retailer and/or contract type without fear of becoming worse off than on the regulated offer. The combination of late payment fees (that can be higher on market offers than on the regulated offer) and pay on time discounts in NSW means that customers that pay late can actually be worse off if they switch from the regulated offer to a market offer.

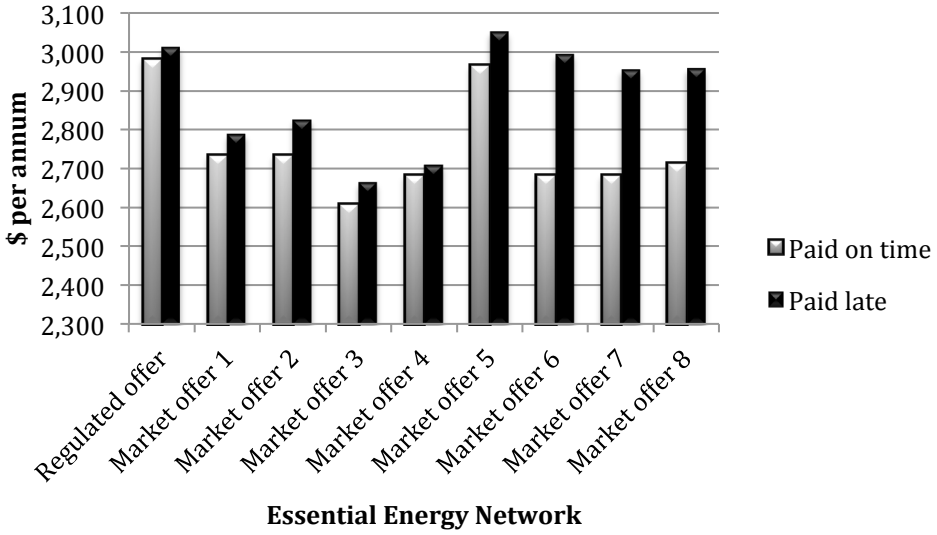
Chart 3 below shows the estimated annual bill for households that always pay on time and always pay late on various offers (regulated and market offers) in AusGrid's network area. A late paying customer risks being significantly worse off if they switch to 'Market offer 6'. This offer includes a 10% discount on the usage component of the bill if paid on time, but as its rates are slightly higher than the regulated rates and it includes a late payment fee, a late paying customer with average consumption would be $225 worse off on this market offer compared to the regulated contract.

Chart 3 – Estimated annual bill for customers that pay on time vs. pay late, electricity offers as of July 2012, Single rate, 7200kWh (GST inc)[20]



This phenomenon is not confined to AusGrid's distribution area. Late paying customers can be worse off on a market offer in all network areas. Further, it is not always the same retailer that has the 'worst offer' for each area. In Chart 4, showing estimated annual bills in the Essential Energy area, it is 'Market offer 5' that produces higher bills for late paying customers compared to the regulated rate. While the potential amount a worse-off customer would pay is less than in AusGrid's area, Chart 4 also highlights that only half the market offers (Market offers 1-4) would actually be attractive to late paying customers with average consumption in Essential Energy's area. Market offers in Endeavour Energy's network area (Chart 5) show a similar story.

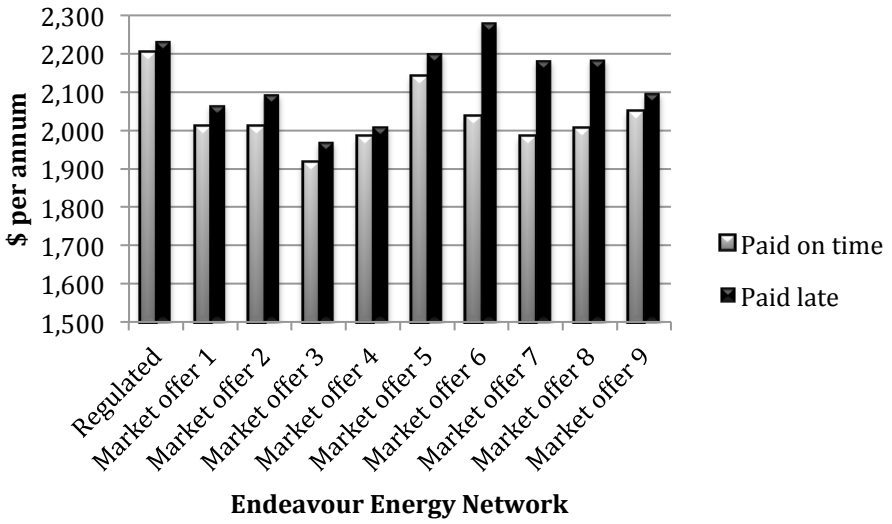
Chart 4 – Estimated annual bill for customers that pay on time vs. pay late, electricity offers post July 2012 as annual bills, single rate, 7,200kWh (GST inc)[21]



20 Annual bill calculation includes discounts, pay on time discounts and late payment fees as per energy offer. Chart based on Mauseth Johnson, above n 19, 17.

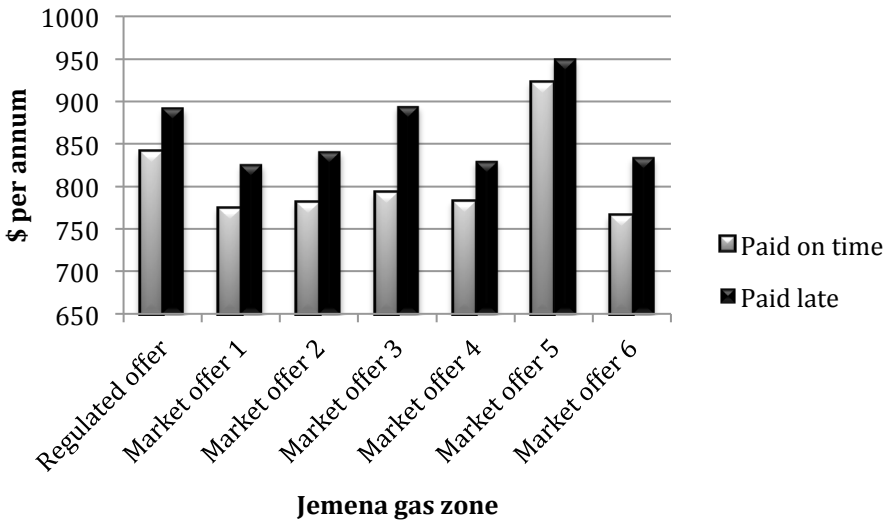
21 Ibid (Chart 14) Note that this chart shows a similar pattern if calculations are based on a two rate with controlled load instead (8,000kWh per annum, 30% off-peak1).

Chart 5 – Estimated annual bill for customers that pay on time vs. pay late, electricity offers post July 2012 as annual bills, single rate, 7,200kWh (GST inc)[22]



This issue can also be seen in retail gas markets. Chart 6 compares the regulated offer to market offers in the Jemena gas zone and demonstrates that late paying customers could be worse off if choosing two out of six market offers. However, in relation to gas market offers, it is not only late paying customers that risk being worse off. The rates applied to 'Market offer 5' are significantly higher than the regulated rates, so any average consumption household switching from the regulated offer to this market offer would be worse off.

Chart 6 – Gas offers in Jemena/AGL area: Estimated annual bill for customers that pay on time vs. pay late (based on 24,000Mj and 4 bills per annum, inc GST)[23]



22 Ibid (Chart 13)

23 Annual bill calculation includes discounts, pay on time discounts and late payment fees as per energy offer. Chart based on Chart 17 in ibid, 22.

PIAC contends that the use of additional fees and charges for the regulated offers provides the retailers with an enhanced opportunity to apply similar fees and charges for their market offers. This is supported by evidence from Victoria, where retailers are banned from applying late payment fees to their standing offers and while they are free to do so in regard to market offers, no retailer has introduced late payment fees to date. As discussed elsewhere in this submission, market offers largely mirror standard/regulated offers with the most common aspect of differentiation between the two offer types being additional discounts (subject to prompt payment) applied to the market offers in 'exchange' for a fixed term contract. As such, the use of additional fees or charges on the regulated offers in NSW may have caused a negative outcome for retail competition. After all, regulatory constraints are not only about constraints imposed on retailers, they can also surface as constraints on the competitive market.

On a more positive note, this can easily be changed—a move likely to give consumers increased confidence in the competitive market. It is, however, important that these aspects of the market are considered as part of the review and not as a possible add-on solution or recommendation. Price regulation is just one aspect of the energy retail market and broader regulatory arrangements can assist or impede competition as well. PIAC firmly believes the use of late payment fees in relation to regulated offers is currently impeding retail competition in the residential energy market.

Recommendation 5

PIAC recommends that the AEMC investigate the impact of late payment fees and charges on regulated offers in impeding the effective functioning of retail energy markets in NSW.

4.4 The retail price setting process

The retail price setting process, involving a single regulated tariff (per metering type) for each network area, has contributed to the very low levels of tariff and product innovation in NSW since the introduction of full retail competition. This issue is discussed in detail in section 6.2 below. While PIAC takes the view that this has impeded product differentiation and impacted on the effectiveness of competition to date, PIAC does consider this to be something that can be changed, either through the regulatory price-setting framework or through deregulation.

4.5 The gas wholesale market arrangements

PIAC is concerned that the gas wholesale market arrangements in NSW make it difficult for new retailers to enter the retail market. A relatively recent report on gas wholesale markets and retail competition in NSW and Victoria, supported by PIAC, argues that the Short Term Trading Market (STTM), with its contract carriage model, brings another layer of complexity to the NSW gas retail market.

PIAC accepts that these are relatively early days still for the STTM, but remains concerned about the barriers it creates for new entrants and ultimately the effect it has on competition in the gas retail market. In NSW, customer market share is more concentrated and consumption levels, as well as retail margins, are lower than those in Victoria. The aforementioned report concluded that:

> It would seem that the Sydney STTM, for instance, is yet to deliver the level of flexibility in supply that would encourage new entrant gas retailers, particularly as it is built around trading imbalances rather than trading upstream gas and capacity, both barriers to a second tier retailer having competitive and reliable gas supply costs.[24]

The same study conducted a handful of detailed interviews with gas industry representatives, and while these comments should not be viewed as representative survey results they do indicate that industry figures regard the NSW gas market as less competitive than the Victorian gas market. The report states that:

> Stakeholder comments on the level of retail competition in Victoria and NSW varied somewhat but only one incumbent retailer assessed the level of retail competition to be the same in both states. Another incumbent retailer was of the view that retail competition is stronger in Victoria than in NSW and pointed out that outside Victoria, networks are more conservative and try to capture the full cost of connection up front.[25] Furthermore, the same stakeholder thinks this approach needs to be reviewed if the aim is to get a greater take up of gas, as the up-front connection charges currently works as a deterrent. Another stakeholder observed that while Victoria is clearly more competitive than NSW, we should be optimistic about the NSW market due to recent wholesale market developments.[26]

Barriers to entry due to wholesale market arrangements combined with low penetration and low average household gas consumption in NSW mean that PIAC is pessimistic about effective competition in the gas retail market for small consumers in the near future. Section 6 discusses gas retail market issues in more detail.

Finally, regarding other features, PIAC is not aware of any unique features attached to mainstream NSW energy retail products compared to other jurisdictions. Dual fuel products appear to be billed as separate accounts where the only 'single product link' is that gas is only offered in conjunction with electricity in some instances. This is not an unusual approach amongst smaller retailers (and regularly occurs in Victoria as well), but it does indicate that some retailers struggle to make a profit in the gas retail sector and will, as such, only offer these contracts if the customer buys electricity too (where the retailer presumably is able to make a profit). Bundling with other services such as telephone or internet is not a common practice in NSW. However, in the ACT, for example, ActewAGL and TransACT offer discounts and other unique product features through the bundling of services. PIAC is not aware of such mainstream product features in NSW, Victoria, South Australia or Queensland.

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24 Hughson, B, & Mauseth Johnston, M, *Gas wholesale markets and retail competition in NSW and Victoria* (2012), 51.

25 In this context, conservative behaviour means that the networks seek recovery of connection costs through up-front connection charges. For low volume end-users, such fees can create a disincentive to the take-up of gas as a 2nd fuel source.

26 Hughson, B, & Mauseth Johnston, M, above n 24, 40.

5. Market Conduct

Based on retail transfer data published by the Australian Energy Market Operator (AEMO), retailers compete for small customers in NSW and transfer rates appear to have increased since the sale of the retail businesses in March 2011. Although the transfer rates (in percentage terms) are lower than those in Victoria, it is clear that NSW customers (including small customers) continue to switch between retailers and contract types.[27]

However, PIAC believes that for the purposes of this review, it is more important to know what motivates customers to switch between retailers and/or contract types, and whether customers are actually able to identify a better offer. *Choice? What Choice?* found that the number one reason for households to switch electricity retailer was the price or cost of electricity.[28] This finding is consistent with other surveys, such as the IPART surveys of electricity customers in Sydney/Blue Mountain/Illawarra and Hunter/Gosford/Wyong and AEMC commissioned surveys in Victoria, ACT and South Australia.[29] If the NSW energy retail market is truly competitive and consumers actually exercise informed choice, we would thus expect to see transfer rates correlating with retail price increases and product offerings.

IPART reported in December 2012 that second tier retailers had become more active in the NSW residential electricity market and that changes to energy prices had impacted on competition and the marketing activities of NSW retailers. The IPART report states:

> While multiple energy retailers have been licensed in NSW for some years, many of these increased their marketing activity and number of customers in 2011/12. In addition to marketing by new entrants, many of the retail suppliers conducted large marketing campaigns in 2011/12, including door-to-door sales, online switching sites and general advertising… Energy prices increased significantly on 1 July 2011, and again on 1 July 2012. This led to an increase in media coverage, and greater public awareness of energy market issues and the competitive retail market.[30]

In relation to gas and switching, PIAC recommends that the AEMC not only assess switching rates but also the proportion of customers that switch gas supplier independently of switching electricity supplier. The aforementioned report on the gas markets in Victoria and NSW argued that:

> As a result of recent energy price increases consumers appear to be more aware and willing to switch to a better offer if able to search and compare. However,

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27 See for example AEMO, *NEM Monthly retail transfer statistics – December 2012* (2013).

28 Schetzer, above n 2, 74

29 IPART, *Residential energy and water use in Sydney, the Blue Mountains and Illawarra – results from the household survey 2008* (2008); IPART, *Residential energy and water use in Sydney, the Blue Mountains and Illawarra – results from the household survey 2010* (2010); Wallis Consulting, *AEMC Review of Competition in the Gas and Electricity Markets – Consumer Research Report* (2008); McGregor Tan Research, *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets – South Australia* (2008), Roy Morgan Research, *Effectiveness of Competition in the ACT Electricity Retail Market – Residential Users*, (2010).

30 IPART, *Customer service performance of electricity retail suppliers, 1 July 2007–30 June 2012 – Information paper* (2012), 7.

> anecdotal evidence suggests that consumers search and compare electricity offers rather than gas offers. An obvious explanation for this may be that practically all households receive electricity bills and if they are connected to both electricity and gas, the electricity bill is usually the higher of the two… In terms of promoting [full retail contestability] in the [National Energy Market], and to assess potential deregulation of retail prices in NSW, how consumers think about their gas contracts and what motivates or initiates switching should be investigated.[31]

As evidence shows that most second tier retailers are unable to compete with incumbent retailers' gas offers, it is important that gas switching and consumer motivation is thoroughly examined.[32] There is of course a possibility that consumers simply assume that a retailer with competitive electricity rates will also have competitive gas rates or, alternatively, that consumers are not overly concerned about their gas bill and value the efficiency of dealing with one single retailer more than comparing gas rates. PIAC, therefore, recommends that the AEMC examine whether gas consumers are ill informed of gas rates and unable to readily compare offers. PIAC believes that gas retailing and gas consumer behaviour need to be examined in terms of understanding market behaviour and customer motivation. As gas continues to be regarded as the secondary fuel to electricity, information and insight into electricity retail markets are better than those available for gas markets.

Recommendation 6

PIAC recommends that the AEMC thoroughly examine consumer experiences in participating in the retail gas market, including their motivation for doing so and the number of gas customers who switch retailers independent of switching electricity supplier.

5.1 Product and service improvements

PIAC can find little evidence to demonstrate that competition has improved retail service levels in NSW. Indeed, the IPART report notes an increase in customer complaints has paralleled the increase in market activities such as marketing, switching and price changes.

As argued in section 4.6 above, PIAC believes that regulatory arrangements have impeded some service improvements in the retail market, especially in regard to late payment fees. At the same time, PIAC has detected some improvements in relation to additional fees and charges being applied to market contracts. These improvements include some retailers offering a 'house moving guarantee', where the customer will not face exit or connection fees if they move but stay with the same retailer, and some removing account establishment and/or moving homes fees.

In August 2012, a study by St Vincent de Paul Society reported that:

> Gas market offers, unlike electricity market offers, often have an account establishment fee. For example, a customer on AGL's regulated offer looking to switch to Origin's market offer may save $25 per annum due to discounts, however the customer is hopefully unlikely to take up this offer as it has an account establishment fee of almost $35. Of course retailers can use their

31 Hughson, B, & Mauseth Johnston, M, above n 24, 46-48.
32 Ibid.

> discretion and may waive the account establishment fee, but these fees can be seen as a deterrent to switching and it is incomprehensible why customers are asked to pay to become customers in a competitive market.[33]

PIAC, therefore, regards the removal of some of these additional fees and charges as a positive market development. PIAC welcomed the NSW Government's initiative to ban exit fees being applied to contracts that have been changed by the energy retailer. PIAC supports the position put forward in a report by the St Vincent de Paul Society and Alviss Consulting, which:

> [R]ejects the rationale that retailers must be allowed to charge early termination fees because of the cost of acquiring customers. That cost should be built into the rates that they offer. We do, however, accept that retailers must be able to change their prices as they pass through new network charges, taxes, levies etc. over which they have no control. Furthermore, retailers need to be able to manage risk arising from changes to wholesale costs as well as demand, but by being allowed to lock customers into fixed term contracts that they can change the conditions of at any point in time, the risk is largely transferred from the retailer to the customer.
>
> There are many practical options that can be considered in order to more appropriately balance the risk between retailers and customers. Options include to:
>
> 1. Only allow early termination fees to be applied to contracts where the retailer agrees to not increase prices for the period of the contract.
> 2. Require retailers to waive the early termination fee if they increase their rates during the period of the contract.
> 3. Continue with current arrangements but ban early termination fees.[34]

PIAC believes that the issue of late payment fees still needs to be addressed through regulatory changes for the standard/regulated offers that can deliver the necessary market incentives.

Recommendation 7

PIAC recommends that if prices for residential retail electricity and/or gas prices are deregulated in NSW, the NSW Government ban all early termination fees on retail supply contracts.

5.2 Tariff innovation

PIAC is unable to detect any significant tariff innovation in the NSW retail energy markets. Retailers continue to offer single flat rate, inclining block electricity tariffs, declining block gas tariffs and three-part TOU tariffs. These tariff shapes clearly reflect the shape of the underlying network/distribution tariffs, and market offers therefore reflect both the underlying network tariff as well as the regulated tariff.

Minor tariff shape divergences do occur sometimes. One retailer may, for example, offer a different consumption threshold for its first block (eg, 1750 kWh per quarter instead of 1000 kWh per quarter), while another retailer may decide to make it a flat rate altogether by removing

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33 St Vincent de Paul Society, *NSW Energy Prices July 2009 – July 2012*, (2012), 7.

34 St Vincent de Paul Society and Alviss Consulting Pty Ltd, *The National Energy Market – In a bit of a state?*, (2012), 8.

the consumption-based step increase. While these minor differences can have a material impact on customers' energy bills, PIAC questions whether the typical consumer registers these differences and, if so, whether they influence that consumer's decision making. PIAC takes the view that these tariff divergences have little to do with competition and marketing and that they occur instead because of retailers' billing systems and/or tariff shapes offered in other networks or states.

5.3 TOU and retail competition

PIAC's main concern in relation to TOU pricing and competition is the added complexity and risk TOU pricing brings to retailing. As previously stated, the three biggest electricity retailers in NSW currently have a combined market share of 95%. These retailers are all well equipped to proceed with time varying pricing structures and, importantly, offer customers associated products and services, such as smart meter compatible web portals.[35] For retailers, time-varying pricing is not just about being able to overlay a retail tariff on a time-varying network tariff, it is also about value add products such as customer interface. The start up or entry cost for a new retailer will clearly be greater in a TOU environment and retailers without a varied customer portfolio may find it more difficult to manage the risk created by time-varying prices.

5.4 Customer information

The various comparison websites provided by the jurisdictional regulators in NSW, Victoria, Queensland and South Australia have all had different problems when it comes to accuracy and timeliness of consumer information. When PIAC visited IPART's 'My energy offers' site in mid-January 2013, there was a pop-up message stating 'New prices come into effect from 1 July, 2012' and continued with urging customers thinking of entering into a market contract to confirm the exact tariff rates with the retailer.[36] Such messages, whether they pop-up in July or six months later, will not make the user feel confident that the information provided is accurate or up to date.

Direct marketing, through telemarketing or door-to-door sales, appears to be the major marketing activity preferred by retailers. It is, therefore, interesting to note the findings of *Choice? What Choice?* regarding the experience of at least some rural energy consumers in NSW. A cross tabulation of the survey data indicates that customers with the greatest confidence in their knowledge of the energy market are also those least likely to be approached by direct marketing practices. The survey found that those with higher incomes and higher levels of education were more likely to be able to participate effectively in the retail electricity market while:

> Those individuals who indicated characteristics suggesting that they were more likely to be at home during the day, were more likely to be contacted by an electricity supplier. This included concession card holders, people in older age groups, households with an individual who had a health condition or disability, those on lower income levels.[37]

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35 AGL, Energy Australia and Origin have all developed web portals that they offer to their Victorian customers.

36 The 'pop-up' message viewed at www.myenergyoffers.nsw.gov.au/?utm_source=ipart&utm_medium=banner&utm_campaign=launch, at 24 January 2013.

37 Schetzer, above n 2, 75

This highlights the need to ensure that consumer information goes beyond web sites and price comparison services. Section 7 below discusses approaches to reach various groups of disadvantaged consumers.

In its final report in relation to the Victorian competition review, the AEMC included a section on 'possible enhancements to product information for consideration', which among other things stated:

> The [AEMC] is not in a position to make specific recommendations about the implementation of comparator tools or the exact specifications of any such tool. The Victorian Government may wish to investigate in more detail alternative options for improving consumers' access to comparable information. As mentioned above, energy comparators have been the subject of some degree of criticism; however the interactive possibilities of online tools and the level of sophistication that can be incorporated into them arguably outweigh the possible negatives.[38]

Prior to price deregulation, the Victorian Government committed to improving customer information. However, it arguably failed to provide consumers with the timely and accurate information they required as well as failing to sufficiently inform consumers about the service available to them.

Running an up to date and accurate service over time, as well as having the resources to inform consumers about the service, appear to be the three most challenging areas for government/regulator operated information or comparison sites. Although developing a meaningful tool in the first instance is important, this is not where these sites fail. PIAC, therefore, encourages the AEMC to carefully consider the current information available to consumers and assess whether it is sufficient to keep consumers adequately informed to participate in the market. PIAC believes real consumer benefits from energy retail markets can only be achieved with an informed and active demand side, and we strongly discourage the treatment of consumer information as an 'add on', to be delivered if deregulation takes place.

PIAC submits that the history of consumer information campaigns in the energy sector leaves some room for improvement. There seems to have been a general trend of the effective provision of consumer information being listed as a key measure of success at the policy planning stage, to a big announcement at the beginning of the implementation stage, to being underfunded and otherwise neglected as change is rolled out. PIAC contends that accessible, accurate and timely information about energy prices is crucial to create a competitive energy retail market that benefits consumers. PIAC is reluctant to endorse further reforms and anything that increases the complexity of the market before governments show real commitment to funding consumer information programs and ensure industry compliance with regulation. As discussed further below in Section 6.2, accessing effective information is crucial if consumers are going to benefit from competition in energy markets.

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38 AEMC, *Review of the Effectiveness of Competition in Gas and Electricity Markets in Victoria, Second Final Report*, (2008), 49

6. Market performance

6.1 Gas market offers

Research has shown that the level of retail competition in the residential gas market in NSW is between low and non-existent. Unsurprisingly, it is the Sydney Jemena/AGL gas zone that attracts the greatest number of market offers but product offerings, diversity and competition are still low.[39]

Charts 7-8 below show estimated annual bills for regulated and market offers in the Jemena/AGL gas zone for July 2011 to July 2012. Any additional discounts and/or pay on time discounts have not been included in these bill calculations. It should be noted than in addition to more retailers entering this market in 2012, the additional discounts offered on gas market offers in July 2012 were higher than those offered in July 2011. A household with this consumption level could save up to $75 per annum by switching from the regulated offer to the market offer with the greatest additional discount. However, this is also the amount the customer would have had to pay if they exited the contract during the first year. In PIAC's view, the Jemena/AGL gas zone is not highly competitive and other NSW gas zones have even fewer market offers.[40] PIAC, therefore, takes the view that no compelling case has been made that effective competition exists in the NSW retail gas market.

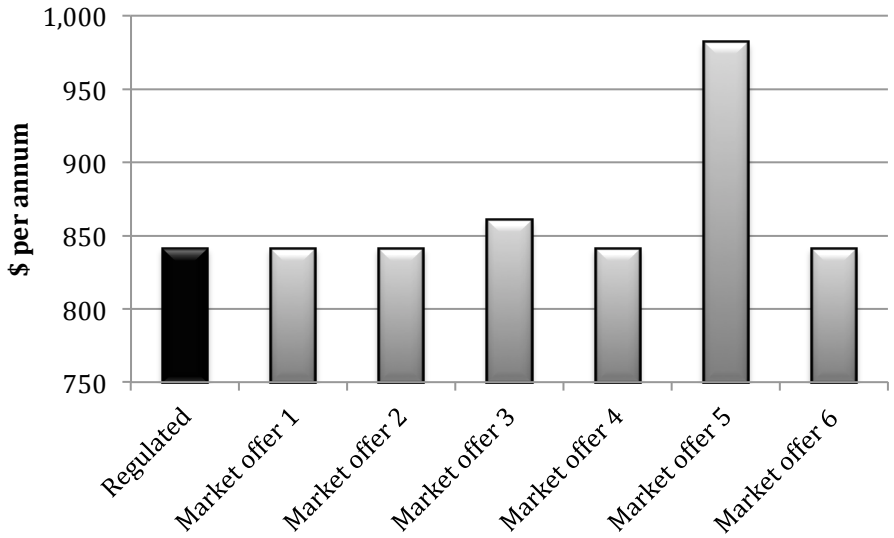
Chart 7 – Regulated vs. market offers, Sydney (Jemena/AGL) Gas offers as annual bills, July '11 (24,000Mj)[41]

39 See Hughson, B & Mauseth Johnston, M, above n 24.

40 See St Vincent de Paul Society, *NSW Energy Prices July 2009 – July 2011* (2011) and *NSW Energy Prices July 2011 – July 2012* (2012).

41 Chart is a slightly modified version of chart 3 presented in Hughson, B & Mauseth Johnston, M, above n 24, 45.

Chart 8 – Regulated vs. market offers, Sydney (Jemena/AGL) Gas offers as annual bills, July '12 (24,000Mj)[42]

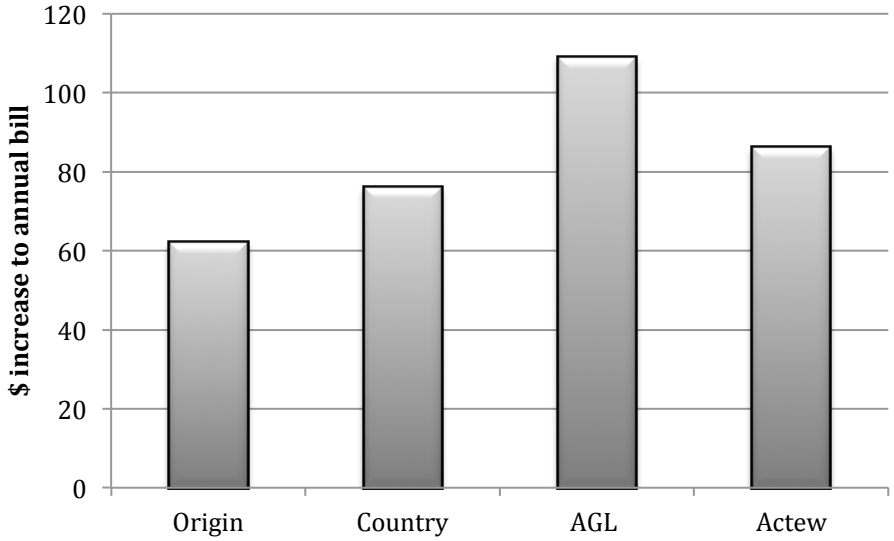


Further, as gas prices increased significantly in the Jemena/AGL zone in July 2012, a customer switching from the regulated rate to the best market offer (with an annual saving of $75) would still be paying more than they did in the previous year. Chart 9, below, shows that the annual bill for the regulated rate in Jemena/AGL's area increased by over $100 from 2011 to 2012. A customer would still be better off by switching but the general price increase versus the size of the market offer discount can explain why many customers believe they became worse off after switching to a market offer.[43]

42 Chart based on bill calculations in St Vincent de Paul Society, *NSW Tariff-Tracking Project, Workbook 3, Gas market offers July 2010-July 2012* (2012), www.vinnies.org.au/energy at 24 January 2013.

43 Schetzer, above n 2, 68.

Chart 9 – Increases to the annual cost of gas from July 2011 to July 2012 for households using 24,000Mj per annum[44]



Recommendation 8

PIAC recommends that the AEMC find that there is not effective competition in the NSW retail gas market and that prices should, therefore, not be deregulated.

6.2 Electricity price and product differentiation

After four years with deregulated retail prices, the Victorian energy market clearly has more price/tariff differentiation than is currently the case in NSW. The Victorian market still has both standing offers and market offers, however retailers determine their own prices and this means that there are multiple standing offers in each network area.

The AEMC's Issues Paper refers to the recent report by the St Vincent de Paul Society and Alviss Consulting that states that product differentiation generally occurs through discounts on standing offers.[45] These discounts can be automatic discounts on the entire bill or on the consumption charges, or they can be conditional upon the bill being paid on time. Retailers operating in NSW, Victoria, South Australia and Queensland all use this approach. The most important difference between the Victorian and NSW energy retail markets in relation to product differentiation is thus the number of standing offers available.

A regulator cannot determine different standing offer prices for different retailers. In a deregulated market, retailers themselves will determine different standing offer prices. The market offers then become the individual retailer's discounted or enhanced offer (often offered in exchange for a fixed contract length).

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44 Based on increases to the regulated offer for gas customers using 24,000Mj per annum. For Essential, Origin and ActewAGL, the increases are based on the average increases of regulated offers in those gas areas.

45 AEMC, above n 13, 34.

Charts 10 and 11 below show how the diversity in standing offers impact on the diversity of tariffs in Victoria compared to NSW.

Chart 10 – NSW: Estimated annual bills (nominal, inc GST) for electricity offers post July 2012 *excluding* discounts and pay on time discounts - Households consuming 7,200kWh per annum, Single rate[46]

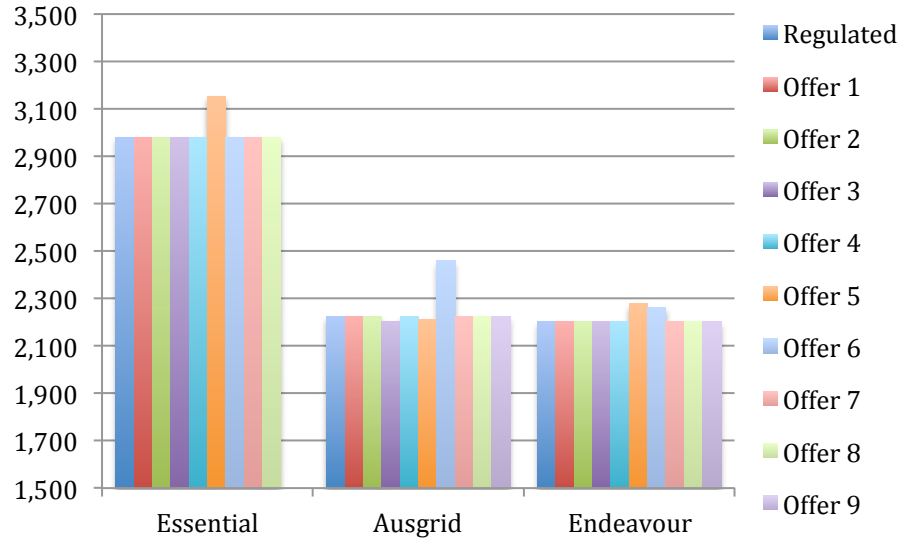
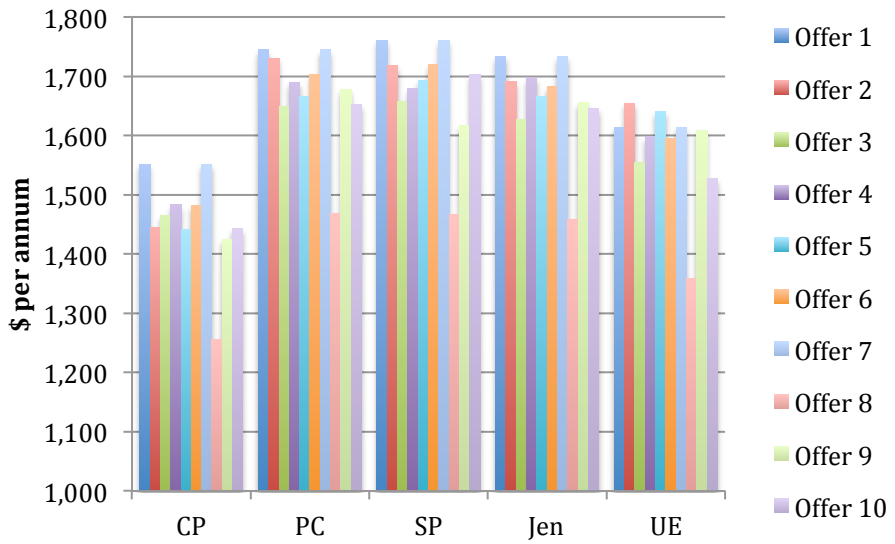


Chart 11 – Victoria: Estimated annual bills (nominal, inc GST) for electricity market offers post July 2012 *excluding* discounts and pay on time discounts - Households consuming 4,800kWh per annum (single rate)[47]

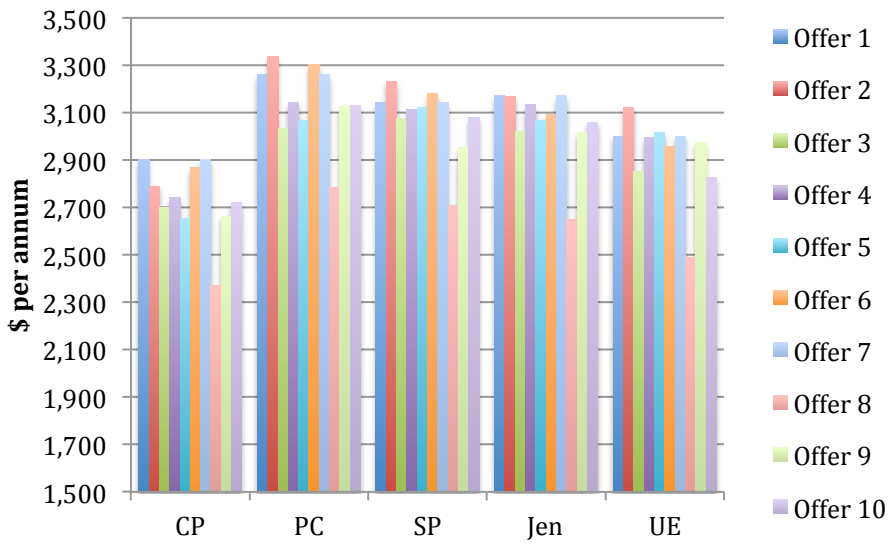


46 Chart modified but based on chart presented in St Vincent de Paul Society, *New South Wales Energy Prices July 2011 – July 2012, An Update report on the NSW Tariff-Tracking Project* by May Mauseth Johnston, August 2012

47 Chart modified but based on chart presented in St Vincent de Paul Society and Alviss Consulting Pty Ltd, *The National Energy Market – In a bit of a state?*, November 2012

While the increased price and product differentiation in Victoria does not protect households from overall price increases, it does offer customers a more meaningful choice when switching supplier. The charts above show estimated annual bills for specific consumption levels (4800 kWh per annum in Victoria and 7200 kWh in NSW – the different consumption levels are determined by available information but these do not meaningfully change the comparability of tariff shapes). Looking at the first four network areas listed for Victoria (Citipower, Powercor, SP Ausnet and Jemena) it is clear that, for example, 'Offer 2' is a better deal than 'Offer 1' for the single rate tariff type at this consumption level. However, If we compare annual bills for high consumption households (10 000 kWh per annum) the retailers producing the lowest annual bill often differ to those for the lower consumption level. Continuing the comparison of Offer 1 and Offer 2, Chart 12 below shows that for high consumption households 'Offer 1' is now lower than 'Offer 2' in three out of five network areas.

Chart 12 – Victoria: Estimated annual bills (nominal, inc GST) for electricity market offers post July 2012 *excluding* discounts and pay on time discounts - Households consuming 10,000kWh per annum (single rate)[48]

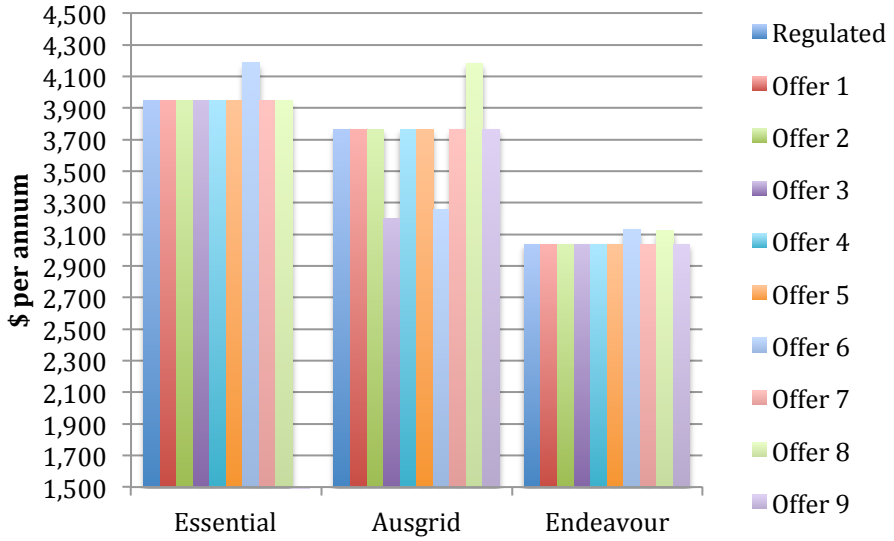


In NSW, bill calculations for households using 10 000 kWh per annum (chart 13, below) show that apart from the two retail offers producing lower bills in AusGrid's network area, there are very low levels of product differentiation.[49]

48 Chart based on annual bill calculations available from St Vincent de Paul Society, *Victorian Tariff-Tracking project, Workbook 3: Electricity Market Offers July 2010 – July 2012,* www.vinnies.org.au/energy, as at 24 January 2013.

49 The two retail offers with lower annul bills in AusGrid's area only apply one step increase (after first 1000kWh consumed) while the other retailers have two step increases.

Chart 13 – NSW: Estimated annual bills (nominal, inc GST) for electricity offers post July 2012 *excluding* discounts and pay on time discounts - Households consuming 10,000kWh per annum, Single rate[50]



PIAC argues that there are two main benefits that can arise from the type of price/tariff differentiation currently seen in Victoria. Firstly, there are direct benefits in the form of savings to be made for households able to identify which retail offers are most suitable for their consumption level. Secondly, such differentiation potentially stimulates the competitiveness of the market. Price/tariff differentiation means that it is not just the discounts offered that entice customers to switch from a standard/regulated offer to a market offer. As a result, these discounts promote searching and switching between retailers, rather than just moving off standard/regulated rates to the same retailer's market offer.

PIAC notes that these benefits are potential benefits only. Without accessible and reliable consumer information available to them, households are unlikely to identify the offers that provide them with direct benefits or search and switch between retailers. This seems to be one of the issues experienced in Victoria. Research by the Victorian-based Consumer Utilities Advocacy Centre (CUAC) has shown that 'many consumers find it difficult to compare different offers and often base their choices on unreliable information provided at the door, on the telephone and online'.[51]

7. Customer access to the benefits of competition

PIAC believes that in a market where retailers determine the price of an essential service, those retailers should assume greater responsibility for the welfare of their customers. The cost of energy is the single most important issue for residential consumers. While PIAC accepts that it is not an energy retailer's responsibility to address poverty, PIAC does argue that retailers have a responsibility—increasingly so in deregulated markets—to assist their customers in staying

50 Chart based on annual bill calculations available from St Vincent de Paul Society, above n 46.

51 CUAC, *Market Power in the Victorian Retail Energy Market* (2012), 9, www.cuac.org.au/index.php?Itemid=30&option=com_docman, at 24 January 2013.

connected to an essential service. Call centre performance, customer relations and hardship policies are all examples of how retailers can go some way to fulfilling this responsibility.

In terms of engaging customers that are unable or unwilling to participate in the market, the role of retailers is more complicated. Assuming that they engage in marketing activities in order to attract customers, it is difficult to see what a retailer can do to engage with customers beyond that. PIAC believes the best advocates for customers who are unable to participate are specific interest groups that look after the welfare of their constituents, for example consumers with physical disabilities or from culturally and linguistically diverse communities. It is important to remember that these groups have their constituents interests at heart and would not recommend or aid engagement if they perceived the market to be unfair or prone to failure. This is exactly why regulation, consumer protections, and reliable consumer information go hand in hand with effective retail competition in the energy market. Energy is a service needed by all and market failure will occur if only a proportion (even if this proportion is the majority) can participate and benefit from competition.

7.1 Options and pathways

PIAC does not support IPART's 'opt-in' approach to the regulated price model.[52] PIAC takes the view that the market itself should be able to perform the role of attracting customers onto market offers. Where market forces have not created this inducement, it is not appropriate for the NSW Government to act on behalf of retailers to place customers on market contracts.

7.2 Gradual approaches

PIAC does not see a convincing argument for progressively 'rolling back' retail price regulation to customers depending on consumption threshold. Consumers' consumption levels are not static, nor are they pre-determined. As the consumption thresholds become lower, this could mean a household may move from being under the threshold to over threshold to back under threshold. Rather than introducing new and more consumption thresholds, we recommend that the AEMC considers the various markets this review covers.

As stated in Section 3.1, PIAC also sees a danger that retailers will target their best rates at high-consumption households when this group is deregulated, leaving less-competitive offers for lower-consumption groups.

Recommendation 9

PIAC recommends that the AEMC not recommend the gradual roll-back of price regulation based on consumption thresholds.

PIAC also submits that there is not a convincing case to be made for why electricity and gas retail markets must be assessed or deregulated at the same time. While there are some retailers that offer both products, the so-called product bundling factor is low and electricity and gas are thus treated as two separate retail products. The two fuels are actually more heterogeneous than similar. In terms of physics, wholesale market arrangements, transportation, distribution network arrangements, market penetration and consumption levels,

52 PIAC, *Charting the affordable course: Submission to IPART's Issues Paper, Review of regulated retail prices and charges for electricity 2013-16*, (2012), 4, www.piac.asn.au/sites/default/files/publications/extras/12.12.20_charting_the_affordable_course_-_submission_to_iparts_issues_paper_for_electricity_2013-16.pdf, at 24 January 2013.

electricity and gas differ substantially and it should be acknowledged that these differences impact on retail market outcomes.

Recommendation 10

PIAC recommends that gas and electricity markets be deregulated together only if competition is found to be effective in both instances.

7.3 Implementation issues

PIAC understands that implementation issues are not within the scope of the AEMC's competition review. However, as the Issues Paper refers to implementation processes and outcomes in regards to previous reviews, PIAC wishes to make some general comments on the issue as well as highlighting some lessons learnt from the Victorian implementation process.

7.3.1 Public information campaign

PIAC submits that if the NSW Government elects to deregulate electricity or gas prices, this will constitute the biggest change to the market since the introduction of retail competition. As such there will need to be a comprehensive consumer information campaign that both precedes and accompanies the process of price deregulation. The information campaign should be led by the NSW Government and include retailers and community organisations.

As well as a broad component targeting the general population, the information campaign should contain specific components that target certain consumer groups in NSW. For example, around 50% of all residential energy consumers in NSW are still on regulated tariffs.[53] As these consumers appear to have had little interaction with the competitive retail market, they are unlikely to be familiar or confident with its workings. As a result, they will require specific extra information assistance to ensure that they are not left any worse off by the transition to deregulated prices. In addition, targeted information should be directed at Specific consumer groups, through the community organisations that work with them. These groups include consumers with physical disabilities and those from culturally and linguistically diverse backgrounds.

Recommendation 11

PIAC recommends that if the NSW Government chooses to deregulate electricity and/or gas prices, the transition should be accompanied by a comprehensive consumer information campaign. The campaign should include specific elements aimed at customers who have not previously participated in the competitive market and minority consumer groups.

Finally, given the scale of the possible change in question, PIAC recommends that price deregulation should not occur until the public information campaign has not only been undertaken, but has been independently assessed as effective. This will go some way to reducing the possible public backlash against the move from consumers who feel they have been 'blind sided' by the change.

[53] IPART, *Review of regulated retail prices for electricity from 2013 to 2016 – Fact sheet* (2012),1.

Recommendation 12

PIAC recommends that if the NSW Government chooses to deregulate electricity or gas prices, this should not take place until a comprehensive public information campaign has been undertaken and independently assessed as having been effective.

7.3.2 Learning from the Victorian experience

In regards to the Victorian deregulation process, the Issues Paper states that:

> In addition to the four broad recommendations above, the Commission provided recommendations around:
>
> - identifying which retailer has responsibility for supplying customers under different circumstances, such as for existing connections versus new connections;
> - the public availability and format of standing offer prices, including the ability of the Essential Services Commission of Victoria to gather and publish on its website current details of all retailers' standing offer tariffs; and
> - providing the Victorian Government the ability to request a review of competition at either short notice or according to an accelerated time frame.
>
> The Victorian Government subsequently decided to remove price regulation for all customers, consistent with Commission's recommendations. In addition to the measures recommended by the Commission, the Victorian Government required each of the electricity retailers to widely publish the retail prices that they offer. The Victorian Government also stipulated that prices could not change more frequently than once every six months.[54]

The Victorian Government required retailers to publish at least one market offer per meter type on the ESC's website (with the assumption that retailers would choose to publish their best market offer). The ESC was also required to publish all gazetted standing offers. Further, retailers were required to post their market offers on their own websites (with clear price and product information statements) and consumers to obtain an offer without entering details such as their address. The Victorian Government also stipulated that standing offer prices could not change more frequently than once every six months.

PIAC understands and supports the original intention of these provisions. However, in reality neither the ESC nor the retailers update their websites in an adequate or timely manner, and some retailers do not make their market offer rates accessible at all. Further, in relation to publishing standing offers, the six month clause has led to some retailers waiting to gazette their new offers until their competitors have done so.

The Victorian legislation would have delivered better outcomes had it stipulated that retailers *could* gazette new standing offers to take effect on 1 January and 1 July every year. That would have increased the likelihood that retailers priced according to their own efficient cost and not according to how much their competitors were charging. Finally, as more and more second tier retailers choose not to gazette new standing offers every six months but still often increase their market offer rates, the Victorian retail market now has some standing offer rates that are lower

[54] AEMC, above n 13, 40.

than the same retailer's market offer rates. These retailers do not have many standing offer customers (if any at all) but it results in a very confusing market dynamic and creates difficulty for those trying to produce effective consumer information.

While the diversity in price and tariff design has been welcomed by Victorian consumer representatives such as the St Vincent de Paul Society, PIAC also understands there are strong emerging issues pertaining to consumer information and transparency in Victoria. PIAC, therefore, encourages the AEMC to reflect on the possibility of consumer information and market transparency not necessarily emerging after the review stage of the process.

Recommendation 13

PIAC recommends that the AEMC consider the Victorian experience regarding the publication of tariff information by retailers when developing advice for the NSW Government on this issue.

7.4 Ongoing assessment of competition and price re-regulation

PIAC strongly supports the AEMC's recommendation pertaining to a state government's ability to request a review of the ongoing effectiveness of competition at either short notice or according to an accelerated time frame. While we are moving towards a National Energy Market, jurisdictional governments still hold key responsibilities in relation to energy policy, and especially energy affordability, through the state based concession and/or rebate schemes for low-income energy consumers. If the AEMC decides to recommend any form of retail price deregulation, it is thus crucial that the NSW Government also retains some powers in order to review the market and possibly re-regulate prices, should the market deliver suboptimal outcomes for NSW consumers.

Recommendation 14

PIAC recommends that the AEMC recommend that if electricity or gas prices are deregulated in NSW, the NSW Government retain the ability to investigate the effectiveness of competition and easily re-regulate prices if this is found to be necessary.

7.5 Improving competition

PIAC does not believe it is appropriate to implement a path to removing retail price regulation where effective competition does not exist. If, for example, the AEMC finds that the level of retail competition in Essential Energy's area is ineffective, the AEMC should make recommendations regarding measures that could increase competition levels and commit to undertake a new review at a later stage.

7.6 Classes of small customers who are unable to access the benefits of competition

7.6.1 Customers with solar panels

PIAC has some concerns about the ability of customers with solar panels to benefit from participating in the competitive retail market. The Issues Paper states that the solar 'feed-in tariff is set by the NSW Government and, therefore, does not differ between retailers'.[55] According to IPART, however, the new voluntary feed-in-tariffs arrangements mean that:

[55] Ibid, 30.

> If you are not eligible for the Solar Bonus Scheme you may still earn a feed-in tariff from your electricity supplier. However, your electricity supplier is not required to offer you a voluntary feed-in tariff. Customers should shop around to find the most suitable electricity offer for them. To assess the most suitable offer, customers should consider more than just feed-in tariffs. They will also need to consider normal electricity usage and other charges, as well as general terms and conditions.[56]

PIAC understands that the NSW voluntary feed-in tariffs (FIT) vary from 0 to 8 cents/kWh (depending on the retailer). Further, it appears that some retailers that have a voluntary FIT only offer it in conjunction with some of their market contracts (ie, solar customers may not be eligible for the contracts with the greatest additional discounts). PIAC also notes that in deregulated Victoria, where all retailers are required to offer a minimum FIT rate of 8c/kWh but are otherwise free to alter terms and conditions (including the general price setting), there are currently examples of market offers available to solar customers that include substantially higher supply charges compared to non-solar offers.[57] Other contracts stipulate that pay on time discounts are not available to solar customers.[58]

7.6.2 Residents of residential parks

PIAC also has concerns about the exposure of some permanent residents of residential parks to competition in electricity markets. Some residents of residential parks have no option but to purchase their electricity from the operator of their park (other parks allow permanent residents in part or all of their facility to purchase their electricity from retailers). Residents in this position cannot access choice about their energy supplier and hence have no scope to benefit from competition.

Currently, those park operators who supply electricity to their residents are not allowed to charge a price that is higher than that under a standard contract in that area. The same provision applies under AER's *Exempt selling guideline* (Class R4), which will come into effect when the NECF is introduced in NSW. The NSW Government currently expects this to occur on 1 July 2013. PIAC notes that if standard contracts are removed under price deregulation, this benchmark for exempt sellers will need to be replaced. While a standard offer may still exist, if this price is not regulated or is set much higher than most market offers, residents of residential parks will pay higher prices without being able to benefit from competition.

Consumers who purchase their electricity directly from park operators face a number of difficulties that stem from being customers of exempt sellers. Firstly, these consumers are often supplied with electricity at a lower quality than standard residential consumers, due to the inferior nature of the distribution network within a park. Secondly, residents of

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56 IPART, *Solar feed-in tariffs* (2012), www.ipart.nsw.gov.au/Home/For_Consumers/Solar_feed-in_tariffs , at 22 January 2013.

57 For example, Simply Energy's single rate supply charge in the Jemena network is 161.362 c/day for solar customers, compared to 122.826 c/day for other customers. Simply Energy, *Price and product information statement – Jemena*, www.simplyenergy.com.au/ftr/product-information-statements.aspx, at 25 January 2013.

58 See, for example, Red Energy, *Latest electricity and gas offers – Vic* 2013), www.redenergy.com.au/page.html?products-victoria, as at 24 January 2013.

residential parks are not able to access assistance under the Energy Accounts Payment Assistance (EAPA) scheme. This means that these residents to not have equitable access to a NSW Government program to help alleviate sudden and unexpected hardship. Finally, residents of residential parks have limited access to effective dispute resolution. This stems from the reluctance of many residents to make a formal complaint against the operator of their park, due to their reluctance to risk harming their relationship with their landlord.

7.7 Retailer initiatives to assist consumers experiencing difficulties in participating in the retail electricity markets

Door-to-door energy marketing is one of the key tools used by retailers to try and engage NSW residential consumers in electricity and gas markets. Proponents of the technique argue that it allows residents to participate in the market by bringing the market to them. Conversely, PIAC has had long-standing concerns about the extent to which those consumers who are marketed to in their homes or on the phone are participating in a truly competitive market, when they are generally only receiving information from marketers about a small number of offers available from the company employing the marketer in question.

However, PIAC believes that where marketers are acting on behalf of a single supplier, consumers will generally realise that the information they are receiving will only relate to that company. PIAC's greater concern is with door-to-door marketing from energy comparator and switching services. These for-profit companies present themselves as providing a comparison service that aids consumers in selecting the single best offer available to them, rather than the best offer out of the selection that the marketer is being paid to present or the offer on which the marketer will receive the greatest commission. *Choice? What Choice?* noted that 'effective [market] participation requires consumers to have a sufficient level of awareness of alternatives to enable them to make an informed choice as to which option will be most advantageous to them'.[59]

To overcome this problem, PIAC recommends that requirements be introduced regarding the transparency of all marketing by comparator services. This should include a requirement for the comparator service to disclose that they are receiving a commission for signing up a new customer and that there is an independent price comparator service available.

PIAC believes that currently, these door-to-door marketing initiatives are most effective for the retailers seeking to acquire new customers, rather than in helping consumers overcome the challenge of benefiting from participation in the competitive residential retail energy market. Increased transparency surrounding the commissions paid to comparator and energy switching services will increase the effectiveness with which consumers can participate in the energy market.

Recommendation 15

PIAC recommends that a requirement be introduced for for-profit energy contract comparison services to disclose that they receive a commission from the energy companies to which they

[59] Schetzer, above n 2, 72.

sign up consumers and alert all consumers to whom they provide information about energy offers to the existence of independent price comparator tools.

8. Conclusion

There are a number of issues PIAC would like the AEMC to examine as part of its review of the effectiveness of competition in NSW. These include the impact of late fees in influencing the effectiveness of competition in NSW and the effect of a market that is highly concentrated between three big retailers. In addition, PIAC recommends that the three NSW network areas should be examined as different areas. The report *Choice? What Choice?* showed that the residents surveyed in at least some regional centres of NSW are exposed to much lower levels of competition than their counterparts in greater Sydney, the Hunter and Illawarra areas. Regarding gas markets, PIAC recommends that the AEMC examine supplier switching rates independent of changes in electricity supplier.

At this point, PIAC remains open minded about the effectiveness of competition in the NSW electricity market, particularly in the AusGrid and Endeavour Energy network areas. However, PIAC does not believe that effective competition exists in NSW gas markets. As a result, PIAC is not able to support price deregulation in the NSW residential retail gas market at the present time.

In the event that the AEMC finds that competition is effective and the NSW government elects to deregulate electricity and/or gas prices, PIAC has a number of recommendations regarding the transition to a deregulated market. Firstly, PIAC does not support a process of gradual deregulation based on consumption thresholds. This approach is problematic due to the fact that consumers may move in and out of different consumption groups and the fact that retailers may target their best offers at the highest consuming households. Secondly, a comprehensive public information campaign will need to precede the deregulation process, including specific components targeted at those who have not previously participated in the competitive market and specific consumer groups such as those from culturally and linguistically diverse backgrounds. Price deregulation should not occur until after this information campaign has not only taken place, but has been assessed as effective. Finally, any deregulation of prices must be accompanied by strong regulation, to ensure that retailers do not reduce their provision of electricity-related services in the new environment.