

8 July 2013

Australian Energy Market Commission
PO Box A2449
SYDNEY SOUTH NSW 1235

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Dear Sir/Madam

Review of competition in retail electricity and natural gas markets in New South Wales

AGL Energy Limited (**AGL**) welcomes the opportunity to respond to the Draft Report that the Australian Energy Market Commission (**Commission**) released on 23 May 2013 on its Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales (**Draft Report**).

AGL strongly supports the Commission's draft findings that competition exists in respect of the retail sale of electricity and gas to small customers in New South Wales and is delivering benefits for customers. We also welcome the Commission's draft recommendation that retail price caps be removed for all customer segments at the same time, and the Commission's recognition that the removal of price caps is likely to improve the development of the market and encourage further growth.

AGL wishes to provide the Commission with specific feedback and comments on particular issues that the Commission has raised throughout its Draft Report. We have divided our comments into sections based upon the structure of the Commission's assessment as set out in the Draft Report.

Commission's assessment of competition for retail sale of electricity and gas

AGL supports the Commission's conclusion that effective competition exists in respect of the retail sale of gas and electricity to small customers in New South Wales. We make the following comments in response to specific issues that the Commission raised in the Draft Report in relation to its assessment of competition:

- Time of use pricing

We agree with the Commission's conclusion that the existence of price regulation has been a factor in explaining the current lack of widespread availability of time of use products. We also agree that removal of price regulation will be likely to encourage greater flexibility in retail product offerings and tariff structures. As the Commission has recognised, retailers operating in a price regulated environment in which their retail margin is capped for regulated products face a significant commercial risk in structuring a retail tariff that does not involve a pass through of network costs. Accordingly, retailers have had limited incentive to offer time of use retail tariffs, or to allow customers to switch between time of use and non-time of use tariffs, unless this is matched by corresponding network tariff structures.

The dependence of time of use pricing on the installation of appropriate metering has also placed a limitation on the ability of retailers to freely develop time of use products. However, in an environment in which retail price caps are removed, a more widespread roll out of interval meters is most likely to be accompanied by an uptake in the development of time of use products by retailers, as this will become a way in which retailers can innovate and demonstrate product differentiation.

This will be further supported by the greater clarity that has emerged in the industry over roles and responsibilities associated with metering with the recent endorsement by the Standing Council on Energy & Resources of the Commission's recommendation of contestability for all metering types. This will be further clarified when the New South Wales Smart Meter Taskforce arrives at its findings.

The Commission has observed in its Draft Report that consumers do not typically have a complete understanding of time of use products generally, or of the choices available to them in moving onto or off time of use tariffs. AGL is not surprised by the Commission's observations in this regard. For the reasons set out above, retailers have not, to date, faced a strong commercial incentive to develop a wide range of products with time of use tariffs that are independent of whether a customer is facing a time of use network tariff. Therefore, retailers have not generally had the need to prioritise the delivery of information to customers about time of use pricing.

However, as products with time of use pricing become a more significant part and proportion of retailers' product offerings, it will be imperative for and in retailers' best interests to explain these products fully to customers so as to encourage their maximum take up. Accordingly, any knowledge gaps being experienced by customers now is due more to a lack of widespread penetration of time of use products in the market (in turn driven by lack of metering contestability), than being evidence of a lack of effective competition.

In any case, AGL agrees that information about time of use pricing would be a useful part of the consumer engagement and education campaign that the Commission is developing a blueprint for, in preparation for the more widespread uptake of these products in the future.

- Interface by retailers with gas distribution networks

The Commission specifically sought stakeholder comment on the extent to which differences in the way in which retailers interface with gas distribution networks in New South Wales as compared with other States constitutes a barrier to entry or expansion in the New South Wales retail gas market. AGL has not found this to be a significant barrier to entry or expansion in New South Wales. We further note that AEMO has for some time been investigating the need for standardised business-to-business (B2B) and business-to-market (B2M) communications across gas retail markets, and undertook a cost benefit assessment in this regard. AEMO's conclusion was that such standardisation is unnecessary and should not proceed.

Removal of retail price caps

AGL strongly supports the Commission's draft recommendation to remove retail price caps for all small customers at the same time. AGL agrees that this option would eliminate the possibility of market distortions arising from the retention of price regulation for some customers. It would also enable all customers to benefit from the increased innovation and expansion of product choice that is likely to result from price deregulation.

We make the following specific comments about issues that the Commission has raised in its Draft Report in relation the removal of price caps:

- Price and market monitoring re-regulation

AGL recognises the benefits that price and general market monitoring would have following the removal of retail price caps. AGL considers that it would be sensible for the AER to perform the market monitoring role that it is required to under the National Energy Customer Framework (**NECF**), and for IPART to perform a price monitoring function, given its experience in this area gained through its current price regulation role.

AGL agrees with most of the indicators that the Commission identified in its Draft Report as being useful to demonstrate the level of competition that exists in the market over a period of time, such as:

- the number and market share of suppliers and year on year changes;
- switching rates for the whole market and between retailers;
- the range of tariffs on offer and average prices by tariff (taking into consideration the discounts offered also); and
- the number or percentage of customers on standing and market offers.

However, we disagree with the suggestion of regulatory monitoring of retailer revenues or retailer margins. AGL has consistently been of the view that regulatory attempts to identify the costs incurred by retailers is a very inexact science, and so any suggestion that this exercise be continued for the purpose of identifying 'retailer margins' has very little practical merit. Further, the policy position underpinning this recommendation appears confused – it presupposes that there is an 'acceptable' level of revenue or margin available to a retailer, beyond which some punitive action should be taken. This conflicts with the basis on which deregulation is being recommended – that is, that there is a competitive market and the market is the best mechanism to determine the efficient price and therefore the revenues and margins earned by retailers. We also note that such monitoring in fact goes beyond the level of regulatory scrutiny that currently exists in an environment in which prices are regulated.

There would be further practical difficulties associated with relying upon retailer margins or revenue as an indicator of market competitiveness. Given the vast array of corporate and financial structures that retailers may choose to utilise, there would be no consistent or conclusive finding that could be drawn from comparing retailer margins or revenues. Accordingly, monitoring and analysing such data would not be assured of delivering useful and robust conclusions in any case.

- Triggers for reintroduction of price regulation

We agree with the Commission that there would be merit in placing in the New South Wales government the reserve power to re-regulate retail energy prices in the event that competition ceased to be effective. It is imperative that there be clear, transparent, and objective criteria prescribing exactly when such a power could be exercised. Further, such a power should only be able to be exercised in the clear case of sustained market failure in the form of effective competition ceasing to exist in respect of the retail sale of gas and/or electricity.

We consider that the arrangements that exist in Victoria in this regard should be used as a guide for New South Wales. As the Commission would be aware, re-regulation can only take place in Victoria if the Commission finds that competition is not effective, and recommends the reintroduction of price controls. In the same way, if retail prices are deregulated in New South Wales, the only trigger for re-regulation should be a finding by the Commission that competition is ineffective and a recommendation by the Commission that price controls be re-imposed. The Commission is the most appropriate entity to perform this role, given its expertise, objectivity, and independence in this regard.

We do not agree with the Commission's suggestion that a possible trigger for re-regulation could be a reduction in switching rates to less than 10% over a 12 month period of time. The re-introduction of price regulation, once it has been removed, should be viewed as a last resort measure that is appropriate only in the event of clear and sustained lack of competition (across multiple measures as outlined by the Commission). While such an occurrence would be one factor considered by the Commission, no individual indicator of competition is able to reliably reflect this conclusion. Nor should the recommendation for re-regulation be made by an entity other than the Commission.

AGL does also caution against undue reliance being placed upon switching rates as a leading indicator of effective competition, such that any reduction from current levels could be considered indicative of a reduction in competition. This is particularly the case given the general move in the industry away from doorknocking as a means of marketing energy products to customers. This is likely to lead to a reduction in churn over the short to medium term. However, such a drop should not be considered to be indicative of any reduction in the level of competition in the market, but rather, a move to a level that is in fact more sustainable in the long term. This shift may see retailers placing more focus upon customer retention activities. Such conduct is undoubtedly reflective of a

competitive market, however would not be demonstrated by increased customer switching rates.

The trigger for the Commission to be tasked with performing such a re-review of competition should be based upon the range of indicators of competition that the Commission is considering as part of its current review. Again, it should not be based upon any individual factor but rather a range of indicators of market behaviour that together suggest that competitive forces have become ineffective and customers are facing detriment as a result. A reliance on a single indicator without reference to market conditions more generally would be inefficient and would risk tasking the Commission with unnecessary and costly reviews.

Other measures to promote competition

We agree with the Commission that it is important to ensure that measures are in place that would work alongside price deregulation to protect consumers and promote competition. We wish to provide specific comments on some of the issues that the Commission has considered in this regard:

- Hardship customers

AGL agrees with the need to ensure that customers facing financial hardship that impacts their ability to pay their energy bills should receive the benefit of retailers' customer hardship programs. This should exist independently of the regulation or deregulation of energy prices.

In particular we note that price regulation should not be viewed as a way in which to protect vulnerable customers. It is in fact a highly ineffective way in which to reduce or manage vulnerable households, and represents a poor *de facto* hardship policy because it will not achieve outcomes consistent with reducing hardship, and in the attempt to do so is likely to damage the competitive market. Deregulated markets encourage the introduction of greater pricing innovation and the development of products that are likely to better suit vulnerable households. Regulated tariffs on the other hand discourage such diversity of product and tariff offerings.

Rather than retaining price regulation once a market is competitive, it is most effective for governments (working with retailers) to deploy resources aimed at ensuring retailers and social welfare agencies have appropriate information to encourage such households to adopt the best tariff for their particular circumstances.

We note that NECF contains a comprehensive regime under which retailers are required to have customer hardship programs which meets certain minimum criteria, and which must be approved by the AER. We note, and agree with the fact, that these customer protections under NECF will exist independently of whether prices are regulated or not.

- Regulation of contract terms

AGL considers it to be prudent for the Commission to rely upon the provisions of NECF, accompanied by the derogations that the New South Wales government has agreed to, to ensure that customers are adequately protected in their dealings with energy retailers. NECF was designed to provide a suitable consumer protection framework for a deregulated energy market. Further, the development of NECF arrangements and the decision to implement it in New South Wales as of 1 July 2013 has taken place over a lengthy period of time involving extensive consultation with industry and consumer groups.

The key contract terms that the Commission has identified, being late payment fees, early termination fees, and the process for customers at the end of a fixed term contract, are all important issues that have been the subject of extensive stakeholder consultation. This has resulted in clear and prescriptive rules being developed to ensure that customers' interests are appropriately protected.

Accordingly, it is unnecessary for the Commission to seek to strengthen the policy around these issues, or indeed the consumer protection framework provided by NECF more broadly, as part of its current review. These issues have been fully considered in the course of the development of NECF, and a clear regulatory framework for application in New South Wales has been agreed.

Consumer engagement

The consumer engagement blueprint that the Commission is in the process of developing in consultation with the industry will be a very useful tool to set the parameters within which the consumer education campaign which should accompany a move to retail price deregulation is structured.

It is highly beneficial for this blueprint to sit alongside the Commission's overall conclusions about the effectiveness of competition and its recommendations to remove retail price caps. It will then be able to guide the nature of the information that is provided to customers, and ensure that effective channels are utilised to deliver the most appropriate information to the widest cross section of consumers. AGL is pleased to be working with the Commission on these issues.

The Commission has recognised throughout its Draft Report the importance of enabling customers to compare competing energy offers in an informed way. AGL agrees entirely with the Commission's focus on this issue. However, before identifying alternative ways in which to provide such information to customers, there may be merit in assessing the effectiveness of the mechanisms that have been implemented through NECF to achieve this objective.

The National Energy Retail Law (**Retail Law**) and National Energy Retail Rules require the AER to mandate how retailers must present their pricing information to customers. The AER is required by the Retail Law to develop and implement a Retail Pricing Information Guideline (**Guideline**) for energy retailers. The aim of the Guideline is to assist customers to readily compare standing offer and market offer prices offered by retailers, and to provide direction to energy retailers about the provision of data and information to the AER for the purposes of its price comparator tool on its Energy Made Easy website. The AER's price comparator tool will also allow consumers to enter their previous consumption levels to enable them to compare the likely end cost of various energy products.

In the light of this capability, AGL sees no immediate need for an initiative such as the Tariff Information Label that has been proposed by Ofgem in Great Britain to be introduced in New South Wales. All the important information on the sample Tariff Information Label reproduced by the Commission in the Draft Report will be available to customers through the AER's price comparator and the mandatory Energy Price Fact Sheets that retailers must prepare for each energy product they offer.

AGL considers that a prudent course of action is to allow the arrangements under NECF, accompanied by relevant New South Wales derogations, to be implemented in full and given an opportunity to be fully utilised. If, after a period of time, it is determined that weaknesses exist in these arrangements and customers are not being adequately protected or informed, then measures should be put in place to rectify these shortcomings. However, it is premature at this stage to assume that these arrangements will be insufficient or ineffective.

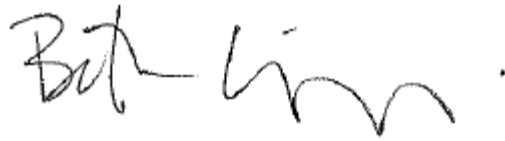
Nevertheless, providing consumers with the tools to be able to compare energy offers in an informed way is essential to enable them to feel confident to participate effectively in the energy market. AGL agrees with the Commission's focus on this aspect of consumer engagement.

Concluding comments

AGL strongly supports the Commission's conclusions in its Draft Report that competition is effective in respect of the retail supply of electricity and gas to small customers in New South Wales, and that retail price caps should be lifted for all small customers at the same time. Further, we agree with the Commission's recognition of the benefits that competition is delivering to small gas and electricity customers in New South Wales. Retail price caps have been successfully lifted in Victoria and South Australia. Guidance should be taken from these jurisdictions in structuring an effective transition to deregulation.

AGL would be happy to provide further information to the Commission should this be helpful. Please contact me on egriggs@agl.com.au or on (03) 8633 6077 or Anita George at ageorge@agl.com.au or on (03) 8633 7212 if you have any questions on these issues.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Beth Griggs', followed by a period.

Beth Griggs
Head of Energy Markets Regulation