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Mr Chris Spangaro
Senior Director
Australian Energy Market Commission
PO Box A2449
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Dear Mr Spangaro

Submission to Australian Energy Market Commission Approach Paper – 2015 Retail Competition Review (Reference: RPR0003)

EnergyAustralia is one of Australia's largest energy companies, providing gas and electricity to over 2.6million household and business customers in NSW, Victoria, Queensland, South Australia and the Australian Capital Territory. EnergyAustralia owns and operates a multi-billion dollar portfolio of energy generation and storage facilities across Australia, including coal, gas and wind assets with control of over 5,000MW of generation in the National Electricity Market.

EnergyAustralia welcomes the opportunity to contribute to the AEMC's 2015 Retail Competition Review both through this submission and the retailer survey. We view this review as an opportunity for AEMC to add to its stock of knowledge of the operation of retail markets and to monitor how markets evolve through subsequent reviews. Particular examples are the NSW and Queensland markets, which will evolve and become more competitive following price deregulation.

Subsequent reviews will allow AEMC to test propositions and identify issues that warrant further analysis and research, and to improve data collection. At present, the readily available market statistics do not allow for a comprehensive evaluation of the extent of effective competition in the market as they exclude internal switching rates (which the AEMC acknowledges in the Approach Paper) and the volume of energy sold through alternative mechanisms, such as entities who have obtained an exemption under the National Energy Retail Law. The latter is currently small in scale but will increase over time.

As such, EnergyAustralia has encouraged the Australian Energy Regulator to consider how it might obtain a clearer indication of the impact of emerging business models on effective competition for the sale of energy as it considers an appropriate regulatory framework.

The remainder of this submission provides more specific responses to those common issues identified in the Approach Paper.

The level of customer activity in the market

As with any good or service, the various customer segments across the retail electricity market are engaged and actively participate to varying degrees. Participation involves switching between retailers and active engagement with a current retailer to obtain a deal that better suits a customer's specific needs and circumstances (internal switching). We are observing this type of behaviour across all customer segments, including our hardship customers.

Other consumers are engaged in some sense but may choose not to act in a particular way (e.g. switch retailers or remain on a standard, rather than market offer) for a range of reasons. For example, energy may only account for a very small proportion of total household expenditure so there is little perceived benefit in switching and they remain with their 'default' retailer and on a 'default' product.

We are aware that the AEMC previously found that urban NSW locations correlated with a greater proportion of consumer groups on regulated tariffs (rather than market offers) that were associated with greater economic advantage, an older population, higher levels of education, and smaller households. In contrast, country NSW locations correlated with a greater proportion of consumer groups on regulated tariffs that were associated with greater economic disadvantage, lower levels of education, and lower levels of mortgages or rents.[1]

There are numerous potential explanations of why and how consumers might choose to participate in retail energy markets. This also complicates the analysis of engagement and participation, which is not easily captured in many standard metrics of competition, such as market share, churn rates and the proportion of consumers on a standard offer.

In general, however, we are observing that consumers are requiring a more personalised service and are engaging with their retailers to seek a service offering that better reflects their needs and preferences to the extent possible within current pricing and regulatory frameworks.

Barriers to retailers entering, expanding or exiting the market

The retail energy sector is heavily regulated with regard to many aspects of the price and service offering. It is no coincidence that competition is less developed and innovation has been stifled in jurisdictions that have retained or are only now relaxing the regulation of prices. Similarly, limitations on commercial flexibility and the recovery of costs – through limits on backbilling and the regulation of disconnections – impact market behaviour and decisions about entry and expansion.

1 AEMC 2013, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales, Report*, 3 October 2013, Sydney

Price regulation has been the most notable example, particularly its contribution to uncertainty about returns to retail operations. EnergyAustralia's previous submissions to retail price determinations have focused on issues such as the appropriate method for calculating efficient costs and the rationale for including specific cost items in the cost build-up. The removal of price regulation removes a key element of market uncertainty for retailers and will promote entry and expansion.

The impact of regulation and regulatory uncertainty is well understood and articulated, and we expect the AEMC is aware of Professor Stephen Littlechild's analysis of the impact on market outcomes of the regulatory framework in the UK and Ofgem's approach to regulatory administration.[2] As mentioned, this means regulators should promote a stable regulatory framework as far as possible as a mechanism for promoting competition.

The degree of independent rivalry

Retail markets across Australia are becomingly increasingly competitive as more restrictive regulations are wound back. We anticipate the collective market share of Tier 2 retailers will likely increase in the near future particularly in NSW and Queensland. The sale of energy is a repeated transaction within a competitive environment and we need to develop competitive service offerings in order to attract and retain our customers. Market share and churn rates are reasonable indicators of the extent of effective competition but are fluid and as mentioned, will not demonstrate how retailers work to retain existing customers.

A further source of competition in retail markets is the emergence of new business models that are utilising new technologies. We note the AER released guidance last year on the regulation of 'alternative energy sellers' and is now seeking submissions on the regulation of 'innovative energy sellers' (i.e. combined solar and storage offerings). Energy provided through 'exempt' mechanisms is a clear alternative to the sale of energy through more traditional avenues, such as a standard or market retail contract. While these sources of competition are relatively small in scale, we expect this to change quickly and therefore, should be taken into account when considering the state of effective competition in the market for retail energy services.

We note the AEMC's comments with respect to emerging business models in its Approach Paper. In particular, the AEMC chose not to expand its market definition to capture energy sold through these mechanisms despite numerous submissions suggesting they represented an important source of emerging competition.[3] This may reflect their current scale and / or the absence of reliable information about their scale and scope. It will, however, become an increasingly significant analytical gap.

As noted, EnergyAustralia will recommend the implementation of a regulatory framework for 'exempt' entities that is neutral with respect to the mechanism through which energy is sold; this may not be feasible under the current National Energy Retail Law.

[2] Professor Stephen Littlechild (2014), *Promoting or restricting competition?: Regulation of the UK retail residential energy market since 2008*, EPRG Working Paper 1415, Cambridge Working Paper in Economics

[3] AEMC, *2015 Retail Competition Review, Approach Paper*, 18 December 2014, Sydney

Customer satisfaction with market outcomes

Engagement and satisfaction in particular is often influenced by price, a significant component of which is outside retailers' control (most notably, network components). Observed increases in the real cost of electricity and the primary sources of those increases have been well documented and it is highly likely that much of the apparent dissatisfaction with the state of the energy market is a function of higher network costs and contribution of regulatory decisions. We encourage the AEMC to consider this as it surveys the views of energy consumers.

Competitive retail energy prices

Discounting and pricing more generally remain the most significant issues for consumers and the primary mechanism by which retailers compete; this is to be expected in a commodity market. The focus on discounts reflects the market's evolution, such as the initial regulation of highly standardised products (such as standard offers with regulated prices) that were the benchmark against which alternative products could be assessed.

However, AEMC is encouraged to also take account of other aspects of retailers' service offerings. Retailers are increasingly competing in areas additional to price as consumers choose value over just discount e.g. companies that offer them self serve, actively help reduce their usage and provide them with customised price plans.

In the small business space and increasingly the residential space, we see demand for more personalised, account management-style customer service. This is more prevalent among some customer segments than others but will become more widespread, particularly as enabling technologies, including smart meters, are embraced on a large scale.

Other elements of service quality on which retailers compete is through energy audits and appliance swaps, advice about energy efficiency initiatives, energy cap plans, additional services (e.g. EnergyAustralia's *Home Services* offering), information about usage profile, and loyalty programs.

This also illustrates the importance of appropriate regulatory settings. Regulation (and its threat) can inhibit price competition and stifle innovation in all aspects of service quality so EnergyAustralia continues to advocate for regulation that is directly targeted to observed and quantifiable problems, and is subject to an appropriate level of impact assessment.

In terms of the monitoring of market outcomes, namely retailer pricing and profits, we note some of the challenges to which the AEMC referred in its 2014 Review of Retail Competition. Examples include difficulties in calculating an 'average' price. As mentioned, retailers are competing by offering a range of different products to suit the needs and preferences of different customer segments. Market data, even where it is available and reliable, is fluid. Furthermore, a simple focus on price will not capture all aspects of the value of respective retailers' service offerings.

Similarly, there are significant challenges in calculating industry cost structures – and therefore, calculating gross and net margins – due to significant differences in business models and cost structures across the diverse range of retailers.

The AEMC previously found it difficult to draw firm conclusions about the state of competition where it has had to rely on imperfect data and simplifying assumptions; this is particularly true for retailer margins and profitability. As such, EnergyAustralia recommends that AEMC should consider behavioural metrics (e.g. extent of switching) and structural considerations (e.g. ease of and extent of entry, regulatory framework) when assessing market outcomes and to understand how retail markets evolve.

If you require any further information with regard to this submission, please contact me on 86281479 or via email at geoff.hargreaves@energyaustralia.com.au.

Yours sincerely,

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