IPART

Independent Pricing and Regulatory Tribunal
New South Wales

Review of the performance and competitiveness of the retail energy market in NSW

From July 1 2017 to 30 June 2018

Draft Report

Energy

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The Independent Pricing and Regulatory Tribunal (IPART)

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Invitation for submissions

IPART invites written comment on this document and encourages all interested parties to provide submissions addressing the matters discussed.

Submissions are due by 2nd November 2018

We would prefer to receive them electronically via our online submission form <www.ipart.nsw.gov.au/Home/Consumer_Information/Lodge_a_submission>.

You can also send comments by mail to:

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If you would like further information on making a submission, IPART's submission policy is available on our website.

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1 Executive summary

The Independent Pricing and Regulatory Tribunal (IPART) reviews the performance and competitiveness of the state's energy retail markets annually, in our role as NSW's electricity Market Monitor.[1] This report to the Minister for Energy and Utilities (the Minister) sets out our draft findings for the year 2017-18.

In response to an additional request from the Minister, the report also includes our draft findings on whether the changes in electricity and gas retail prices into 2018-19 reflect efficient costs in a competitive retail market.[2] Our draft findings on whether retailers are providing acceptable levels of customer service in relation to metering are set out in a separate report, *Retailers' metering practices in NSW.*

1.1 Competition continued to increase but underlying costs remained relatively high

Our draft finding is that competition continued to develop for residential and small business customers in both the electricity and gas retail markets in 2017-18. Each of the key indicators we use in assessing competition were steady or showed increased competition relative to the previous year.

Looking into 2018-19, electricity prices have remained steady compared to 2017-18, and continued to reflect the underlying costs of supply. Gas prices also remained steady despite a small increase in underlying costs, suggesting retail gas margins have declined.

Over the longer term, electricity prices continued to be significantly higher than 10 years ago. But the bulk of this price increase occurred when prices were still regulated. The average electricity bill[3] has increased by around 9% in the Ausgrid and Endeavour networks since prices were deregulated in July 2014, which is around a 1% reduction in real terms when inflation is taken into account. In the Essential network, the average bill has fallen by around 5% since price deregulation, which is a reduction of 13% in real terms. These price changes reflect increases in wholesale costs over the period, which have been either partially or fully offset by large reductions in network costs, particularly in the Essential network.

Although the average bill remains close to 2013 levels in real terms, there has been a widening in the spread between the cheapest and most expensive offers over time. Customers who were not engaged in the market tended to be on the most expensive offers, paying around 20% more than those who had shopped around for a better deal.

1 *National Energy Retail Law (NSW)*, s 234A; National Energy Retail Law (Adoption) Regulation 2013, cl 8A.
2 To analyse this, we compared prices in July 2018 with forecast costs for 2018-19.
3 We have calculated average bills based on customers numbers by network area and a range of assumptions for customer numbers by offer type.

In the electricity and gas retail markets, customers have the ability to switch plans and retailers, which should protect them from paying more than they need to. While customers reported feeling less confident in their ability to choose the right offer for their circumstances in 2017-18, the tools and government initiatives available to help them engage and compare offers on a consistent basis have improved. In addition, the NSW Government has recently made changes that require retailers to assist low-income customers to access lower prices.[4]

Governments also need to provide a stable and predictable energy market framework. In our view, the most effective way governments can ensure sustainable prices in the future is to provide conditions that encourage new investment in the wholesale market to increase supply and replace existing generation as it reaches the end of its asset life.

1.2 Key indicators continued to show increased competition

Since price deregulation, each of the key indicators we use in assessing competition in the electricity and gas retail markets has evidenced increased competition (Table 1.1). For example, another three retailer brands entered the NSW electricity market during 2017-18, bringing the total number of retailers to 24 – eleven more than when electricity price deregulation occurred.

Nine of these 24 electricity retailers were also active in the NSW gas market, including three new gas retailers that entered the market since gas price deregulation occurred on 1 July 2017. All these gas retailers were active in the Jemena distribution network, where 95% of small retail gas customers are located. In each of the ten smaller gas networks (for example, Wagga Wagga, Albury and Queanbeyan) there were up to three active retailers.

In addition, customers remained active in both retail markets, with 19% of customers switching electricity retailers and 14% switching gas retailers during 2017. There was a substantial increase in the number of electricity customers that moved from standing offers to market offers, bringing the proportion of customers on market offers to 83%, compared to 78% last year. This indicates that many new customers engaged with the market for the first time during 2017-18 (at least at their current address).

While retailers have continued to enter the market, the pace at which these small retailers gained market share remained relatively slow. In its recent Retail Electricity Pricing Inquiry, the Australian Competition and Consumer Commission (ACCC) found that the big three retailers ("the big three", AGL, Origin, and EnergyAustralia) have an unfair advantage over the smaller retailers in being able to undertake aggressive retention strategies when their customers decide to switch retailers. It concluded that this conduct is significantly affecting the ability of smaller retailers to gain scale in the market, and made several recommendations to reduce this behaviour.[5]

The ACCC also found that smaller retailers may find it harder to enter and expand their business because it is becoming more costly for retailers to effectively manage their wholesale price risk. The combination of vertical integration and increasing concentration in the national

4 *NSW Social Programs for Energy Code*, December 2017.
5 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, pp 151-153.

electricity market (NEM) has reduced contract market liquidity, and there are now very few suppliers of load-following hedges.[6]

Table 1.1 Change in key indicators of competition in the energy markets in each year

Measure	2013	2014	2015	2016	2017	2018
Electricity						
Number of retail brands/ businesses	15/13	20/16	26/22	26/22	28/23	29/24
Market share of small retailers	7%	7%	10%	11%	14%	15%
Small customers on market offers	60%	63%	69%	74%	78%	83%
Residential customers switching **company** at least once in that year	NA	15%	16%	17%	19%	NA
Gas						
Number of retail brands/ businesses	5/4	6/5	8/6	8/6	12/9	12/9
Market share of small retailers	0%	3%	3%	4%	5%	7%
Small customers on market offers	70%	72%	76%	80%	83%	86%
Residential customers switching **company** at least once in that year	NA	13%	14%	10%	14%	NA

Source: AEMC, *2018 Retail energy competition review, Final Report, June 2018*, pp 97-98, 271-275, IPART, Review of the performance and competitiveness of the retail electricity market in NSW, November 2017, p 2; AEMC, *2018 Retail energy competition review*, Final Report, June 2018, pp 45, 98; AER, *NSW – Small retail customer contract types*, accessed 10 September 2018.

1.3 Prices remained steady into 2018-19

Electricity prices remained relatively flat into 2018-19 in all three electricity network areas. Many retailers held their electricity prices constant in July 2018, and other retailers increased them only slightly. On average, we estimate that electricity prices for residential and business customers increased by 0.2% compared to prices in June 2018 (Table 1.2).

Similarly, gas prices for residential customers in the Jemena network increased by 0.2%, and prices for business customers increased by 1.6%. For the country gas networks, prices fell on average by around 2% for both residential and business customers. This varied between networks, with the prices for AGN Adelong, Gundagai and Tumut falling by around 14%, and the prices for Shoalhaven and Queanbeyan increasing by around 6%.

6 ACCC, *Restoring electricity affordability & Australia's competitive advantage,* June 2018, p 150.

Table 1.2 Average price changes June 2018 to July 2018

	Residential	Business
Electricity	0.2%	0.2%
Gas (Jemena)	0.2%	1.6%
Gas (Country)	-2.1%	-1.6%

Source: IPART calculations based on information from Energy Made Easy and retailers.

1.3.1 Electricity prices reflect the underlying costs of supply

While electricity prices remained stable, we estimate that the costs of supplying customers decreased by around 9% for 2018-19. This is due mainly to substantial reductions in forward wholesale prices of around 35% (when we look at the average forward prices in June 2017, compared to June 2018).

Green costs, which made up around 5% of the overall bill in 2017-18 increased by around 50% in 2018-19. This is mainly because of the large increase in the uptake of solar panels in 2016-17 (which created small-scale renewable energy certificates that must be purchased by retailers). Network costs, which made up 40% of the overall bill, fell slightly in the Ausgrid network (by around half a percent), were relatively flat in the Endeavour network, and rose by 2.4% in the Essential region.

Even though prices have remained stable while costs fell for 2018-19, we consider that average prices currently reflect the level of underlying costs, as retailers have smoothed the impact of wholesale cost changes on bills over a period longer than a single year.

Last year we found that costs rose by 30%, driven by wholesale costs more than doubling (from around $50/MWh to around $115/MWh). However, retailers only increased prices by 15%.

When we considered the cumulative changes in these wholesale costs across 2017-18 and 2018-19, we found that they increased by around 50%. Over the two years, this likely added around 12% to the average costs of supply. This is very similar to the cumulative increase in average bills of 12-16% over the two years, depending on the network area (noting that other cost components also changed).

1.3.2 Wholesale costs of supplying gas have increased

We estimate that the forecast costs of supplying gas (excluding retail costs) in the Jemena region increased by around 2% in 2018-19. This increase was mainly driven by a 13% increase in gas wholesale costs, which are continuing to rise due to tight supply and demand conditions. In the country regions, the forecast costs of supply (excluding retail costs) increased by slightly more than in the Jemena region – between 3% and 6% - because wholesale costs make up a larger proportion of the total costs of supply in country areas.

Since gas bills have remained flat while underlying wholesale costs have increased, retail margins appear to be falling. We consider that in the Jemena region, gas retail prices are likely

to reflect efficient costs of supply, while in country areas these prices are becoming more cost-reflective as more retailers contest the country markets as competition develops.

Table 1.3 Changes in the expected average costs of gas supply for residential customers in 2018-19 (excluding retail) (average across NSW)

	Proportion of total bill in 2017-18	Change in cost component	Contribution to bill change	Proportion of total bill in 2017-18	Change in cost component	Contribution to bill change
	Jemena			Country average		
Wholesale costs	31%	13.4%	3.1%	43%	13.4%	3.5%
Transmission costs	14%	2.3%	0.2%	16%	2.4%	0.2%
Distribution costs	55%	-2.5%	-1.0%	41%	-4.9% to 4.8%	-0.1%

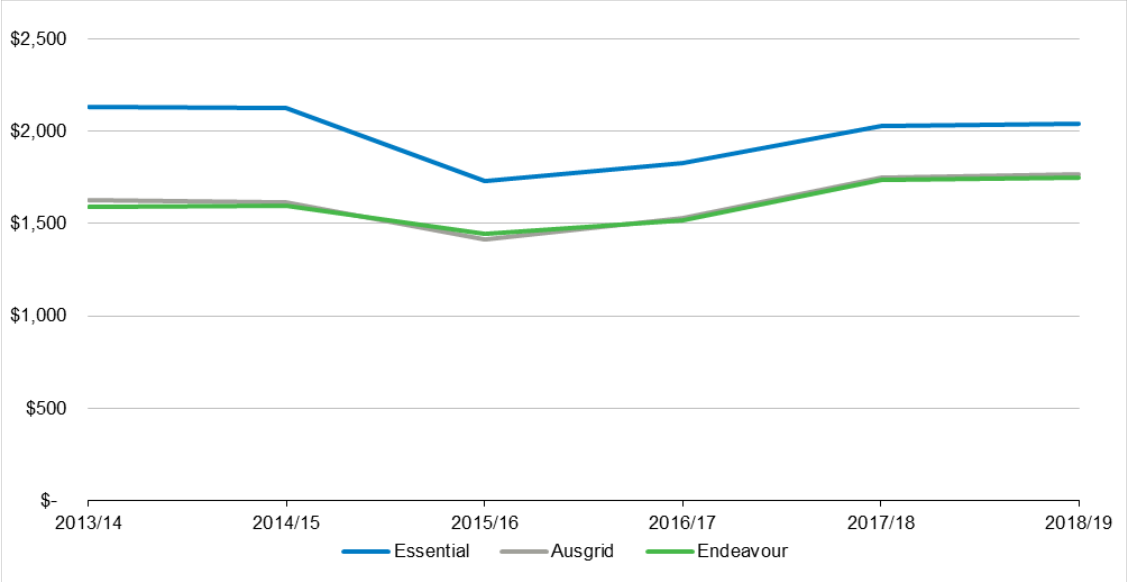
Source: Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW.*

1.4 Average electricity bills have fallen in real terms since price deregulation, but not all customers are better off

Over the period since price deregulation, the average electricity bill has increased by around 9% in the Ausgrid and Endeavour networks, which is a 1% reduction in real terms when inflation is taken into account. In the Essential network, the average bill has fallen by around 5% since price deregulation, which is a fall of 13% in real terms.

Figure 1.1 shows that falling electricity prices in the Essential network area has meant the difference in the residential bills between regional and metropolitan areas has reduced over time. In 2018-19, the average residential bill in regional areas is around 16% higher than in metropolitan areas, compared to 32% higher in 2013-14.

Figure 1.1 Average annual residential electricity bills since price deregulation (5,100 kWh pa, nominal, GST-inclusive)



Note: In previous years, we have calculated electricity bill for a typical customer using 6,500 kWh per year. However, this year we have updated the consumption of a typical customer based on the AER's 2017 electricity and gas bill benchmarks for residential customers.

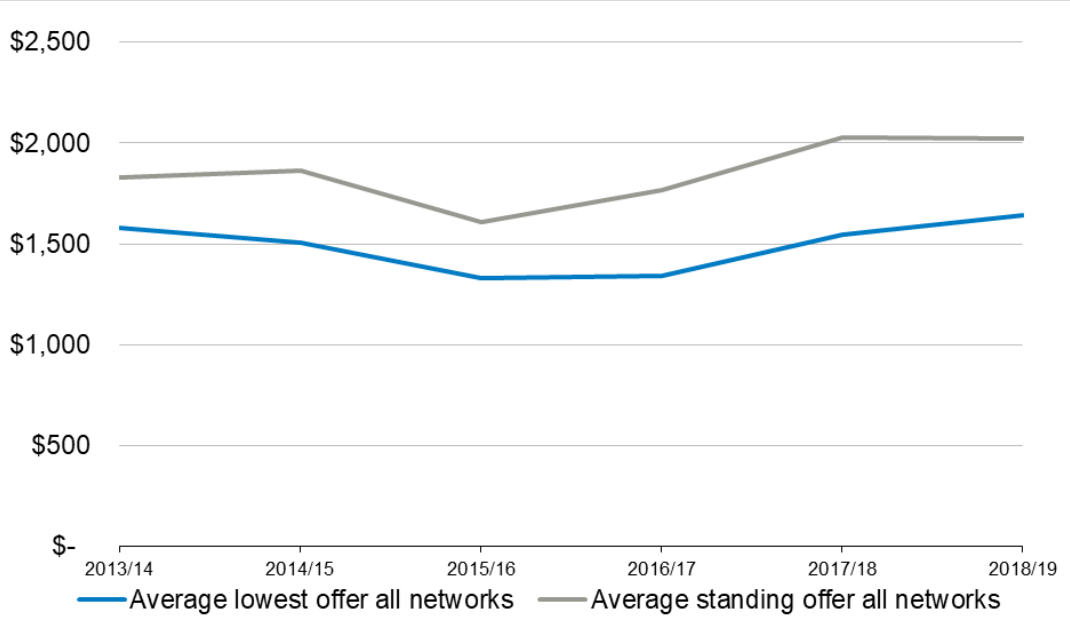
Data source: IPART calculations based on Energy Made Easy data and retailers' pricing information.

The most expensive offers in the market have increased more than the average bill, as the spread between the cheapest and most expensive offers in the market has widened. For Ausgrid and Endeavour customers, the most expensive offers are around 15% to 17% higher than they were when prices were regulated.

Figure 1.2 shows that across NSW, the difference between the cheapest and most expensive offers is around 20%. This is down from around 25% in 2017-18. The customers who tend to pay the highest for electricity are the 17% of customers on 'standing offers' who have not actively engaged in the market at their current address. In addition, we estimate that at least 15% of customers on 'market offers' are also paying 'standing offer' prices because they have not switched offers in the last few years.[7]

[7] AEMC, *2018 Retail energy competition review,* Final Report, June 2018, p 62.

Figure 1.2 Average lowest and standing offer bills for a typical customer 2013-14 to 2018-19 (5,100kWh pa, nominal, GST-inclusive, average across all networks)



Data source: IPART calculations based on Energy Made Easy data and retailers' pricing information.

1.5 Governments and retailers are helping customers engage in the market

Electricity and gas retailers typically have several tariffs for each offer, and different discounts for different offers. This can make it difficult for customers to compare plans. As a result, Governments have focused on measures to help make offers easier to compare, particularly in the period following large price increases in July 2017.

Through the Australian Energy Regulator (AER), the Australian Government administers a price comparator service, Energy Made Easy. This service compares all retailers' generally available electricity and gas offers by calculating annual bills on a consistent basis. The AER made major upgrades to the Energy Made Easy website in September 2018 to make the site more user friendly.

There are also a large number of privately run comparator websites which can also help customers compare and switch offers. The Australian Energy Market Commission (AEMC) and the ACCC have recently made recommendations to ensure that these websites deliver outcomes that are in the best interests of customers.[8]

In addition, the AER made changes to the Retail Pricing Information Guidelines (RPIG) that commenced in August 2018.[9] These guidelines set out the requirements for how retailers must present their offers to customers. They require retailers to include an annual bill

8 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 84; ACCC, *Restoring electricity affordability & Australia's competitive advantage,* June 2018, p 282.

9 AER, Retail Pricing Information Guidelines 2018, https://www.aer.gov.au/retail-markets/retail-guidelines-reviews/retail-pricing-information-guidelines-2018, accessed 26 September 2018.

comparison table for different consumption levels on a consistent basis so that customers can compare offers without having to make any calculations.[10]

New measures to increase awareness of price changes have also been introduced. From August 2018, retailers must notify customers when their discount will end.[11] Similarly, the AEMC has made a new rule commencing in February 2019 that will require retailers to notify their customers of any price changes in advance (currently retailers are not required to notify customers of prices changes until after they have taken place, and often these notifications are not obvious).[12]

Following a rule change request in June 2018, the AEMC will also consider whether to introduce an obligation on retailers to write to their standing offer customers every 12 months to inform them that there are cheaper offers in the market.[13] Following several roundtable meetings with the Prime Minister in August 2017, many of the retailers did this voluntarily last year.[14]

1.5.1 The NSW Government has also introduced new measures

The NSW Government has also introduced a package of measures to assist customers. Customers will be able to receive assistance from Service NSW to help them choose the best offers and switch retailers under the NSW Government's new initiative announced in June 2018. Service NSW is piloting the new service in selected locations prior to a state-wide rollout later this year.[15]

The NSW Government has also introduced new obligations to help low-income and rebate customers move onto lower market offers. From January 2018, retailers have been required to use all reasonable endeavours to inform and assist any customer receiving a rebate to identify the most appropriate market offer for that customer at six-month intervals. Retailers are required to report six-monthly on the measures taken to move rebate customers to market offers, the effectiveness of these measures (ie, how many customers have changed offers), and how much these customers save as a result.[16]

10 AEMC, *2018 Retail energy competition review*, Final report, June 2018, pp 108-109.
11 AEMC, *Notification of end of fixed benefit period,* https://www.aemc.gov.au/rule-changes/notification-of-end-of-fixed-benefit-period, accessed 27 September 2018.
12 AEMC, *Advance notice of price changes,* https://www.aemc.gov.au/rule-changes/advance-notice-price-changes, accessed 27 September 2018.
13 AEMC, *Long term standing offer notice,* https://www.aemc.gov.au/rule-changes/long-term-standing-offer-notice, accessed 27 September 2018.
14 AEMC, *2018 Retail energy competition review,* Final Report, June 2018, p 50.
15 NSW Government, *NSW Budget: 'One-click energy switch' could save households more than $1000 a year*, June 2018, https://www.nsw.gov.au/your-government/the-premier/media-releases-from-the-premier/nsw-budget-one-click-energy-switch-could-save-households-more-than-1000-a-year/, accessed 26 September 2018.
16 *NSW Social Programs for Energy Code*, December 2017.

1.5.2 A benchmark tariff would be less problematic than a regulated default tariff

We consider that a non-binding benchmark tariff could also assist customers to assess the value of different offers, without reducing levels of customer engagement or creating additional risks for retailers. On the other hand, re-introducing price regulation or a 'default tariff' is likely to lead to lower levels of competition and higher prices.

In the short term a default tariff could help disengaged customers from paying excessive prices. However, over time it is likely to result in less customers actively shopping around in the market as the benefits from switching fall. In turn, this smaller market for 'active' customers would lead to less vigorous competition and innovation, with fewer retailers competing in this market (Figure 1.3).

Figure 1.3 Impact of price regulation

Even if a regulated tariff was introduced, regulators would still need to set prices to reflect the costs of supply to ensure that retailers remain financially viable. If the underlying costs of supply increase, then the default retail tariff would also increase. To illustrate, the largest electricity price increases that occurred in NSW over a sustained period were between 2007-08 and 2013-14, when retail prices were regulated. During this period prices more than doubled, driven by large increases in network costs.[17]

1.6 Governments need to provide stable energy market frameworks

Since 2013-14, network costs for electricity retailers (which make up around 40% of the average bill) have fallen by around 23%.[18] However, these cost reductions have been offset by significantly higher wholesale costs in 2016 and 2017. These costs rose due to increasing gas costs and a reduction in the supply of wholesale electricity following the closure of Hazelwood power station.

Therefore, the most effective way of limiting further energy price increases in the future is to provide conditions that encourage new investment in the wholesale market to increase supply and replace existing generation, as they reach the end of their asset lives. This means providing a stable and predictable investment environment.

Network prices are expected to continue to fall in real terms, and more can be done to keep network prices as low as possible in the future. For example, to avoid future over-investment

17 IPART, *Review of regulated retail prices and charges for electricity From 1 July 2013 to 30 June 2016, June 2013*, p 18.

18 ACCC, Restoring electricity affordability & Australia's competitive advantage, June 2018, p 13.

in the network, which is the main cause of higher bills, governments should set distribution reliability standards using an economic framework that balances the cost of reliability with the value that customers place on it.

1.7 Have your say on this Draft Report

We invite all stakeholders to make written submissions in response to this Draft Report by 2 November 2018. More information on how to make a submission is provided on page iii at the front of the report. Late submissions may not be accepted.

We do not have a specific set of questions for stakeholders to comment on. Instead, stakeholders are invited to address any of our draft findings, or provide additional detailed information that is relevant to our assessment.

We will consider all the issues raised in submissions before finalising our findings, and providing a Final Report to the Minister by 30 November 2018.

1.8 List of draft findings

1 There are no substantial barriers to setting up a retail business in the NSW electricity market. However new retailers may face increased economic barriers that would require them to have considerable financial capacity to gain market share due to:

- reduced contract market liquidity making it harder for retailers to effectively manage their wholesale price risk
- inconsistent jurisdictional regulations; and
- increased regulatory and political invention in the energy market. 29

2 There are no substantial barriers to setting up a retail business in the NSW gas market. However, higher wholesale prices and access to pipeline capacity may increase the economic barriers, which means that a new retailer needs considerable financial capacity to gain market share. 33

3 There is evidence of rivalry between energy retailers who are offering a large range of prices, and a growing range of products and services. 39

4 The average electricity bill for residential and small business customers increased by 0.2% in the period from June 2018 to July 2018. However, costs have decreased by around 9% for 2018-19. This is mainly due to substantial reductions in forward wholesale prices of around 35% in 2017-18 (average forward prices in June 2017, compared to June 2018). 54

5 Although electricity retail prices did not decrease in line with the overall decrease in costs in 2018-19, average prices have remained in line with the underlying total costs. This is because retailers increased prices by less than the change in costs last year. 54

6 A detailed review of electricity retail prices and margins is not necessary as the ACCC has recently completed its Retail Electricity Pricing Inquiry. 54

7 The average gas bill for residential coastal customers in the Jemena network (which covers 95% of NSW gas customers) increased by 0.2% for residential customer and increased by 1.6% for small business customers between June 2018 and July 2018. In country areas, the average gas bill for country residential and small business customers decreased by around 2%. However costs (excluding retail costs) have increased by between 2% and 6% in 2018-19 driven by a 13% increase in wholesale costs due to tight supply-demand conditions in eastern Australia. 63

8 It is not necessary for IPART to undertake a more detailed review of retail gas prices and margins as this work is currently being done by the ACCC. 63

9 The average electricity bill increase for residential customers in metropolitan areas since price deregulation is around 9%. This is a real decrease in prices of 0.8% (once CPI is accounted for). 67

10 The average electricity bill decrease for residential customers in regional areas since price deregulation is 4.5%. This is a real decrease in prices of 13.1% (once CPI is accounted for). 67

11 The fixed proportion of residential customers' electricity bills has increased on average by 18% between 2013-14 and 2017-18, reflecting how retailers have chosen to recover their costs. This is a real increase in prices of 7.5% (once CPI is accounted for). 69

12 Since price deregulation, the bill for a typical Ausgrid small business customer has increased by 1%, and decreased by 7% and 18% in the Endeavour and Essential network respectively (comparing the most common offers currently in the market to the regulated prices in 2013-14). These are all price reductions in real terms. 73

1.9 What the rest of this report covers

The rest of this report explains our review and draft findings in more detail. It is structured as follows:

- Chapter 2 outlines the context for the review, and the process and approach we used to reach our findings,
- Chapter 3 analyses the structure of the market and the barriers to entry and expansion,
- Chapter 4 discusses our findings on the level of rivalry between retailers, as well as prices and the range of products currently in the market,
- Chapter 5 presents our findings on customer engagement and activity,
- Chapter 6 explains our analysis of the changes in costs of supplying electricity in 2018-19, and how this compares to retail prices
- Chapter 7 explains our analysis of the changes in costs of supplying gas in 2018-19, and how this compares to retail prices,
- Chapter 8 analyses how electricity prices have changed since prices were deregulated, and
- Chapter 9 discusses measures to improve customer outcomes.

2 Context and approach

This is our fourth annual report on the performance and competitiveness of the retail electricity market for residential and small business customers. Last year we found that competition for residential and small business customers in the NSW retail electricity market was continuing to develop, however there were opportunities to help customers engage in the market to further improve competition.[19] Since then, a number of other regulators have also reviewed the performance of the electricity market across the national electricity market (NEM).

This is our first annual review of the retail gas market, since retail gas prices were deregulated in July 2017.

As in previous years, the Minister for Energy and Utilities (the Minister), has also asked us to report on the drivers of any price movement into 2018-19 and assess whether these changes reflect efficient costs in a competitive market.

The sections below explain the approach and process we used to perform our role as market monitor, and then summarise recent developments in the retail energy markets that are relevant to our review.

2.1 IPART's market monitoring role

The NSW Government opened the electricity and gas retail markets to competition in 2002.[20] After more than ten years of contestability, the NSW Government decided to remove retail electricity price regulation effective 1 July 2014 and gas price regulation from 1 July 2017.[21] As part of these decisions, it gave IPART a new role to monitor and report annually on competition in the retail electricity and gas markets (Figure 2.1).[22]

Figure 2.1 also shows that a number of other regulators also review the energy retail markets. This is discussed in further detail in Section 2.2.

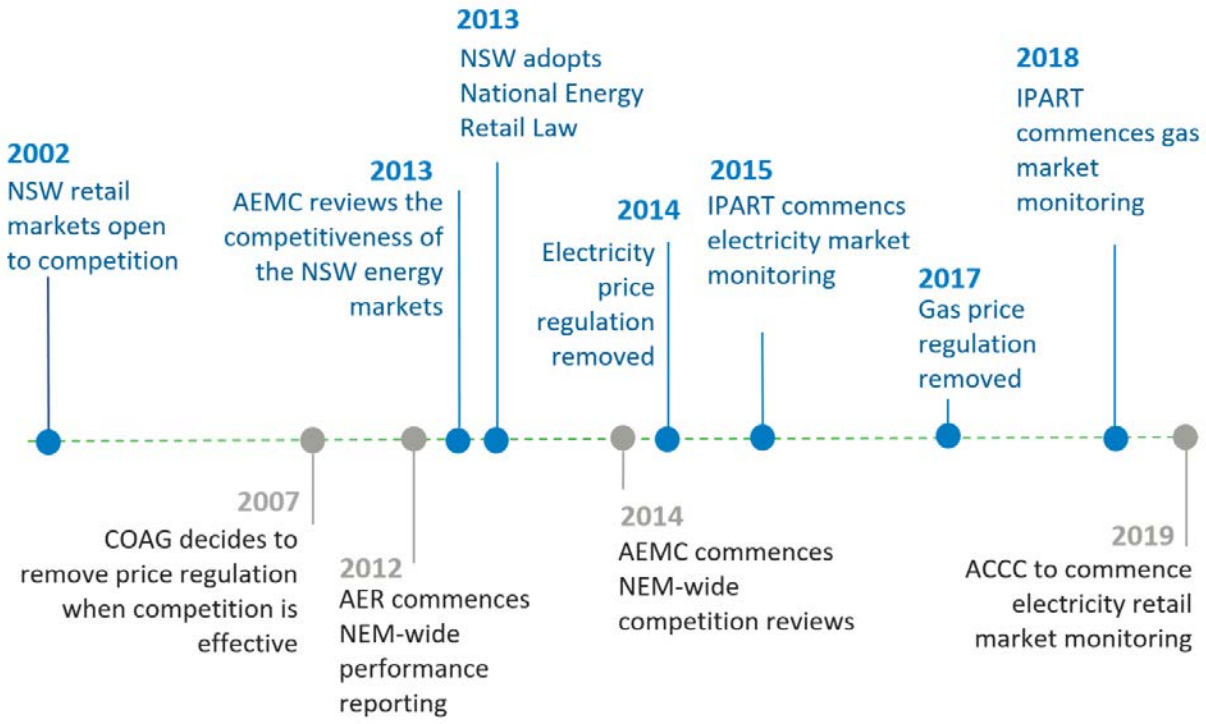
19 IPART, *Review of the performance and competitiveness of the retail electricity market in NSW*, November 2017, pp 1-2.

20 NSW Government Industry & Investment, *NSW Implementation of the National Energy Customer Framework – Policy Paper for Consultation*, September 2010, p 14.

21 Department of Planning and Environment, *Removal of electricity price regulation (deregulation),* https://www.energy.nsw.gov.au/energy-consumers/energy-sources/electricity/removal-of-electricity-price-regulation; accessed 27 September 2018; Department of Planning and Environment, *Removal of gas price regulation (deregulation),* https://www.energy.nsw.gov.au/energy-consumers/energy-sources/gas/removal-of-gas-price-regulation-deregulation, accessed 27 September 2018.

22 IPART is prescribed as the Market Monitor for the purpose of Part 9A of the Act (*National Energy Retail Law (Adoption) Regulation 2013*, cl 8A). *National Energy Retail Law (NSW)*, s 234A.

Figure 2.1 Development of competition in the NSW energy retail markets



Our market monitoring role is set out in the *National Energy Retail Law (NSW)* (the Act).[23] The Act specifies the indicators we must have regard to when assessing the performance of the market for small customers, and the information we are able to have regard to.

The factors that we must report on that help us assess competition in the market are set out in Table 2.1.[24] These factors must be considered in combination – no single factor is conclusive in determining whether competition is effective.

Table 2.1 Factors that help us determine whether competition is effective

Factor we must report on	Location of analysis in this Report
The participation of small customers in the market and, if the Market Monitor thinks it appropriate, particular groups of small customers	Chapter 5
Any barriers to entry to or exit from, or expansion in the market	Chapter 3
The extent to which retailers are competing to attract and retain small customers	Chapter 4
Whether price movements and price and product diversity in the market are consistent with a competitive market	Chapters 6,7

Source: *National Energy Retail Law (NSW)*, s 234A (3).

23 *Ibid.*
24 *Ibid.*

As a result of our findings, we must report on whether a detailed review of retail prices and profit margins in each market is required (Chapters 6 and 7). If we are of the opinion that it is required, we must also consider whether there are any actions needed to improve the competitiveness of the market.[25]

In considering the performance of the market, we are also required to consider prices of electricity for small customers in regional areas (Chapter 8).[26]

We are able to report on any other relevant matters in reviewing the competitiveness and performance of the market.[27] PIAC submitted that it strongly supports IPART explicitly examining the outcomes for vulnerable customers as one of its indicators.[28]

Retailers recently provided data on rebate customers to the Department of Planning and Environment. We are working with the Department to understand whether the new retailer obligations to assist rebate customers to move onto lower offers[29] are improving outcomes for these customers. These new obligations are discussed further in Chapter 9. We will include our findings in our Final Report. As discussed in the next section, the AER reports each year on energy affordability, and assistance given to customers experiencing payment difficulties (including hardship programs) and disconnections.

In conducting our analysis, the Act limits the information we can consider to:

- information provided by the AEMC and the AER,
- any publicly available information, and
- information provided by a retailer with particulars of the number of market offer customers of the retailer, the market offer prices of those customers, the number of customers on each standing offer price offered by the retailer that has been publicly advertised, and those standing offer prices.[30]

25 Section 234A(3) (f) (g) of the *National Energy Retail Law (NSW).*
26 Section 234A(3) (b) of the *National Energy Retail Law (NSW).*
27 Section 234A (3) (h) of the *National Energy Retail Law (NSW).*
28 PIAC submission to IPART Information Paper, August 2018, p 2.
29 *NSW Social Programs for Energy Code*, 11 December 2017.
30 Section 234A (7), (8) of the *National Energy Retail Law (NSW).*

2.2 We have also been asked to conduct two special reviews

The Act also provides for the Minister to ask IPART to undertake special reviews in connection with the energy market. For these reviews, we are not limited in the information that we can consider.[31]

As in previous years, the Minister asked to extend our assessment of electricity and gas price movements beyond the reporting period (2017-18) to include the most recent price changes that have occurred since July 2018 (see Appendix B).

In response to this request we engaged ACIL Allen to review any changes in costs of supplying electricity in 2018-19, and Oakley Greenwood to examine the same for the gas market. If the price changes broadly reflect the changes in the underlying costs of supply, then we would consider that they are consistent with a competitive retail market.

The Minister also asked us to review whether retailers are providing their customers with acceptable levels of customer service in response to requests for new or replacement meters. This follows a change in the energy market rules in December 2017, which transferred the responsibility for meter installation distribution networks to retailers. We have reported our draft findings in a separate report, *Retailers' metering practices in NSW.*

2.3 Our process for this review

In May 2018, we began our review process by releasing an Information Paper by inviting comment on our proposed approach for undertaking our review. We received nine submissions.

We are now inviting stakeholder submissions on this Draft Report. Submissions close on 2 November. Information on how to make a submission is provided on page iii of this report.

We will consider all comments from stakeholders before making our Report to the Minister by 30 November 2018. The timetable and key milestones for our 2018 annual report are summarised in Figure 2.2.

Figure 2.2 Timetable for review

31 Section 234B of the *National Energy Retail Law (NSW)*.

2.4 Other regulators also have monitoring roles

As shown in Figure 2.1 at the beginning of this Chapter, a number of other regulators also review the retail electricity market (Table 2.2). We refer to the findings and analysis of these reviews throughout the report.

Table 2.2 Ongoing energy retail market monitoring reviews

Regulator	Scope of the review	Fuel	Role commenced	Reporting
IPART	Competition and performance – NSW	Electricity and gas	2015 for electricity, 2018 for gas	Final report in November each year
AEMC	Competition – NEM	Electricity and gas	2014	June each year
AEMC	Price trends – NEM	Electricity only	2011	December each year
AER	Performance of market – NEM	Electricity and gas	2013	November each year
ACCC	Prices, profits and margins for retail and wholesale sectors, cost changes and drivers, and barriers to entry - NEM	Electricity only	2019	Every six months in March and August until 2025.

Source: AEMC, *Possible Future Retail Electricity Price Movements: 1 July 2011 to 30 June 2014*, November 2011, AEMC, *2014 Retail Competition Review,* https://www.aemc.gov.au/markets-reviews-advice/2014-retail-competition-review, accessed 25 September 2018, ACCC, *Electricity market monitoring 2018-2025*, https://www.accc.gov.au/regulated-infrastructure/energy/electricity-market-monitoring-2018-2025, accessed 25 September 2018,

2.4.1 The AEMC conducts annual competition reviews

The AEMC began conducting NEM-wide reviews of competition in retail energy markets in 2014.[32] As part of these reviews, it surveys retailers in each year. This year it also surveyed business customers about their experience in the energy markets. In previous years, the AEMC has surveyed residential customers but this year it has reported on the results of a survey undertaken by the Energy Consumers Association.[33]

Before this, the AEMC reviewed the effectiveness of retail competition in electricity and gas retail markets in each jurisdiction (except WA), starting with the Victorian market, which was completed in 2008.[34] If the AEMC found effective competition it would provide advice on ways to phase out retail price regulation.[35] It completed its review of the NSW market in 2013[36], and price regulation was removed on 1 July 2014.

32 These reviews report on NEM-wide trends and also each state separately. *2014 Retail Competition Review*, https://www.aemc.gov.au/markets-reviews-advice/2014-retail-competition-review, accessed 25 September 2018

33 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 2.

34 AEMC, 2014 Retail Competition Review, https://www.aemc.gov.au/markets-reviews-advice/2014-retail-competition-review, accessed 25 September 2018

35 AEMC, *Review of the Effectiveness of Competition in the Electricity and Gas Retail Markets – Victoria*, https://www.aemc.gov.au/markets-reviews-advice/review-of-the-effectiveness-of-competition-in-1, accessed 25 September 2018.

36 AEMC, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales,* October 2013.

The AEMC also reviews electricity price trends on a state-by-state basis each year to provide guidance on likely future price trends, and has been doing so since 2011.[37]

2.4.2 The AER reports annually on retailer performance

Following the implementation of the National Electricity Law in 2012, the AER has been required to report on the compliance and performance of the retail energy market during the previous financial year in November each year. Because NSW did not adopt the National Electricity Law until a year later in 2013, the AER commenced its reporting on the NSW market in 2014. The AER reports on:

- competition indicators including retailers' shares of small and large customer markets, the number of customers on standard and market retail contracts and switching activity,
- energy retailer performance, including customer service and complaints, the assistance given to customers experiencing payment difficulties (including hardship programs) and disconnections, and
- energy affordability, including estimates of the annual bills of households, and bills as a proportion of household disposable income.[38]

2.4.3 The ACCC will commence its market monitoring role in March 2019

The ACCC was asked to conduct a one-off wide-ranging inquiry into electricity supply and prices that was finalised in July this year. It reviewed all parts of the supply chain. One of the recommendations from this review is that state governments close their own price reporting and monitoring schemes in favour of an expanded and strengthened NEM-wide regime undertaken by the AER and supported by powers to compulsorily obtain information from retailers, including full EBITDA data.[39]

The ACCC has now been given this ongoing monitoring role. It is required to report every six months commencing March 2019.[40] Unlike the other regulators reviewing the energy market, the ACCC has broad information gathering powers that enable it to compel information from market participants.

The ACCC will be required to monitor electricity prices and the spread of offers in the market, whether prices reflect the costs of supply, and the profits of generators and retailers. It must also consider the wholesale market, including prices, bidding behaviour, and contract market liquidity, and whether vertically integrated suppliers are restricting competition and new entry. The ACCC also needs to monitor the effect of any policy changes.[41]

The ACCC was also given a role to report on the supply and demand for wholesale gas at least every six months between 2017 and 2020. While the focus of this review is the wholesale

37 AEMC, *Possible Future Retail Electricity Price Movements: 1 July 2011 to 30 June 2014*, November 2011.
38 AER, *Annual report on the performance of the retail energy market 2012-13*, Revised February 2014, pp 2-3.
39 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p xxiii.
40 ACCC, *Electricity market monitoring 2018-2025*, https://www.accc.gov.au/regulated-infrastructure/energy/electricity-market-monitoring-2018-2025, accessed 25 September 2018.
41 *Ibid*.

market for gas, it will also be reviewing retailer pricing, cost and margins over the course of the Inquiry.[42]

2.5 Recent findings of other regulators

In the most recent review of the electricity retail market released in July 2018, the ACCC concluded that the approach to policy, regulatory design and promotion of competition in this sector has not worked well for consumers. In its view, the NEM needs to be reset, and it made 56 recommendations spanning each part of the electricity supply chain for reform.[43] These included:

- **In the wholesale market,** limiting companies with 20% or more market share from acquiring more generation capacity, and new government support to assist new investment by new players in firm generation capacity that have secured at least three customers.[44]
- **In relation to networks,** governments writing down the regulated asset base values for the networks, or providing payments to customers (via the network businesses) equal to the bill impact of any over-investment where network business have been privatised.[45]
- **In the retail market,** replacing 'standing' offers with a 'default' offer at a price determined by the AER for both residential and small business customers, and requiring discounted offers to reference their discounts to the default offer.[46]

Just prior to the release of the ACCC's report, the AEMC released its annual review of retail competition. While it found that structural features of the market showed increased competition (such as new entry into the market, an increasing market share of new retailers, and customers moving off standing offers), it also found that competition is not delivering the expected benefits to consumers.[47]

In particular, it found that energy prices were increasing, and the majority of consumers no longer believe that energy retailers are working in their long-term interest, and customer satisfaction is falling. It also found that retailers were not segmenting the market based on customer preferences and characteristics. Instead, retailers are mostly offering different prices based on customer propensity to switch retailer.[48]

42 ACCC, *East coast gas market conditions have eased, but more gas required to lower prices,* 2 August 2018, https://www.accc.gov.au/media-release/east-coast-gas-market-conditions-have-eased-but-more-gas-required-to-lower-prices, accessed 19 September 2018.
43 ACCC, *Restoring electricity affordability & Australia's competitive advantage,* June 2018, p iv.
44 *Ibid*, p xvii.
45 *Ibid*, p x.
46 *Ibid*, p xiii.
47 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p i. For example, see page NSW summary of key market statistics, pp 272-275.
48 *Ibid*, pp ii, vi, xvi.

3 Barriers to entry

In any market, there may be economic, legal, regulatory or other barriers that constrain the ability of new retailers to enter the market and/or expand their market share. Where these barriers are low, competition will be most effective in protecting customers from excessive prices.

In such a market, the incumbent retailers are under constant pressure to offer competitive prices, products and services, or lose customers to more competitive rivals. In our view, this pressure provides the most effective means of keeping retail prices in line with the efficient costs of supply.

To assess the barriers to entry in the retail electricity and gas markets in NSW, we looked at the number of retailers and brands contesting the market and the market concentration in 2017-18, compared to previous years. We also examined barriers to entry, based on the finding of the ACCC's Retail Electricity Pricing Inquiry, and retailers' views based on the most recent annual survey commissioned by the AEMC as part of its 2018 retail competition review. The sections below outline our draft findings, then discuss them in more detail.

3.1 Overview of draft findings

As at September 2018, there were 24 retailers (and 29 brands) operating in the electricity market.[49] Both the continued entry of new retailers, and the large number of small retailers that are very small operations with low levels of capital indicate that barriers to entry in the market are relatively low. However, it is taking time for small retailers to grow their customer base. The ACCC found that aggressive retention strategies of the big three retailers are likely to be slowing the pace of expansion of the smaller retailers. The ACCC has made two recommendations to limit the opportunity of 'losing' retailers to conduct save activity before the customer transfer has taken place.

The ACCC also found that smaller retailers may find it harder to expand their business because it is becoming more costly for retailers to effectively manage their wholesale price risk. The combination of vertical integration and increasing concentration in the NEM has reduced contract market liquidity, and there are now very few suppliers of load-following hedges.[50]

Of the 24 retailers operating in the electricity market, nine of these are also supplying gas customers. Three of these entered the market last year since prices were deregulated on 1 July 2017.[51]

In the country areas, there are fewer retailers supplying gas customers, with up to three retailers active in any region. In the Shoalhaven and Tamworth regions, there is only one active gas retailer. Uncertainty in the gas market reflecting current wholesale price volatility

49 Energy Made Easy.
50 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 150.
51 AEMC, *2018 Retail energy competition review*, Final Report, 15 June 2018, pp 43.

might be deterring entrants into the market at this time given the fixed costs of negotiating pipeline access and small customer bases in these networks.

However, even where there is only one gas retailer, gas prices are constrained by both the threat of entry from new retailers and also electricity services. If gas retailers increase their prices substantially, customers have the option of switching their appliances from gas to electricity. While customers would incur significant upfront costs of doing so, over the longer term electricity and gas are substitutes and this would pose some constraints on gas price increases.

3.2 There are a large number of retailers contesting in the electricity market

Barriers to entering the market will ultimately affect how many retailers are competing for customers. In general, the greater the number of active retailers, the stronger the level of competition in the market.

As at 15 September 2018, there were 24 retailers (and 29 brands) in the retail electricity market.[52] In October 2017, Amaysim entered the market, after acquiring Click Energy earlier in 2017. It is now offering retail services under both the Amaysim and Click brands. In August 2018, Sumo Energy also entered the NSW electricity market.

Table 3.1 shows that most of the electricity retailers are offering to both residential and business customers. Mojo, Dodo, People Energy, and Sanctuary Energy are only offering to residential customers, while ERM and Next Energy only offer to Business customers.

Most of the electricity retailers are active across the three network areas. There are some exceptions:

- Enova Energy is only active in the Essential Energy network area.
- ActewAGL is only active in the Endeavour and Essential network areas.
- Pooled Energy and Sumo are not active in the Essential Energy network.

Table 3.1 also shows that nine of the electricity retail businesses also offered gas retail services (under 12 brands).[53] This is discussed further in the sections below.

52 AGL owns Powerdirect and a share in ActewAGL, M2 owns both Dodo and Commander, and Snowy Hydro owns Red Energy and Lumo (Lumo Energy will become Red Energy for residential and business customers in New South Wales). Energy Made Easy. Lumo, *Red is the new orange in NSW,* https://lumoenergy.com.au/home-energy/lumo-red-nsw, accessed 27 September 2018.

53 AEMC, *2018 Retail energy competition review,* Final Report, 15 June 2018, p 268.

Table 3.1 Energy retailers contesting in NSW as at 15 September 2018

a	b	Electricity		Gas	
	Retailer	**Residential**	**Business**	**Residential**	**Business**
1	Origin Energy	X	X	X	X
2	EnergyAustralia	X	X	X	X
3	AGL	X	X	X	X
	Powerdirect	X	X		
	Actew AGL	Endeavour, Essential Energy only	Endeavour, Essential Energy only	X	X
4	Alinta Energy	X	X	X	
5	1st Energy	X	X		
6	Blue NRG	X	X		
7	Amaysim	X	X	X	
	Click Energy	X	X	X	
8	Commander	X	X		
	Dodo	X		X	
9	CovaU	X	X	X	X
10	Diamond Energy	X	X		
11	Energy Locals	X	X		
12	Enova Energy	Essential Energy only	Essential Energy only		
13	ERM Business Energy		X		
14	Red Energy	X	X	X	X
	Lumo Energy[a]	X	X	X	
15	Momentum Energy	X	X		
16	Next Business Energy		X		
17	People Energy	X			
18	Pooled Energy	Endeavour, Ausgrid Only			
19	Powershop	X	X		
20	QEnergy	X	X		
21	Sanctuary Energy	X			
22	Sumo	Ausgrid, Endeavour only			
23	Mojo	X			
24	Simply energy	X	X	X	X

a Lumo is a subsidiary of Snowy Hydro and is no longer offering electricity to new customers.

Source: Energy Made Easy.

3.3 The retail market remains relatively concentrated

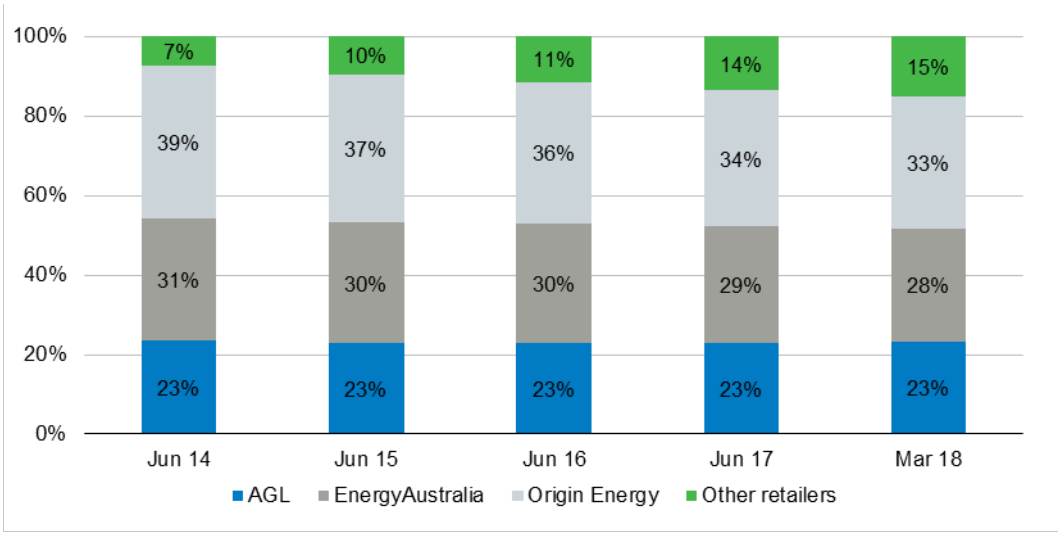
The retail electricity market remains concentrated, however there is a consistent trend of smaller retailers slowly gaining market share at the expense of the big three retailers in NSW (Figure 3.1).

As at the end of June 2018, the big three retailers had around 85% share of the NSW electricity market for small customers, made up of:

- AGL (23%)
- EnergyAustralia (28%), and
- Origin Energy (33%).[54]

While the combined market share of the 21 smaller retailers only sits at 15%, it has doubled from 7%, when prices were first deregulated in NSW.[55] We expect that it would take some time for a small retailer to build a substantial market share. Snowy Hydro, under its Red Energy brand, has the highest market share of the smaller retailers. As at June 2017, it had around 45% of customers who were not with the big three, or around 5% of the market overall (Figure 3.2).[56] One of the reasons why it might have been able to expand its market share relatively successfully is because it also owns wholesale assets, which provide it with a natural hedge.

Figure 3.1 Change in electricity retailers' market share for all small customers



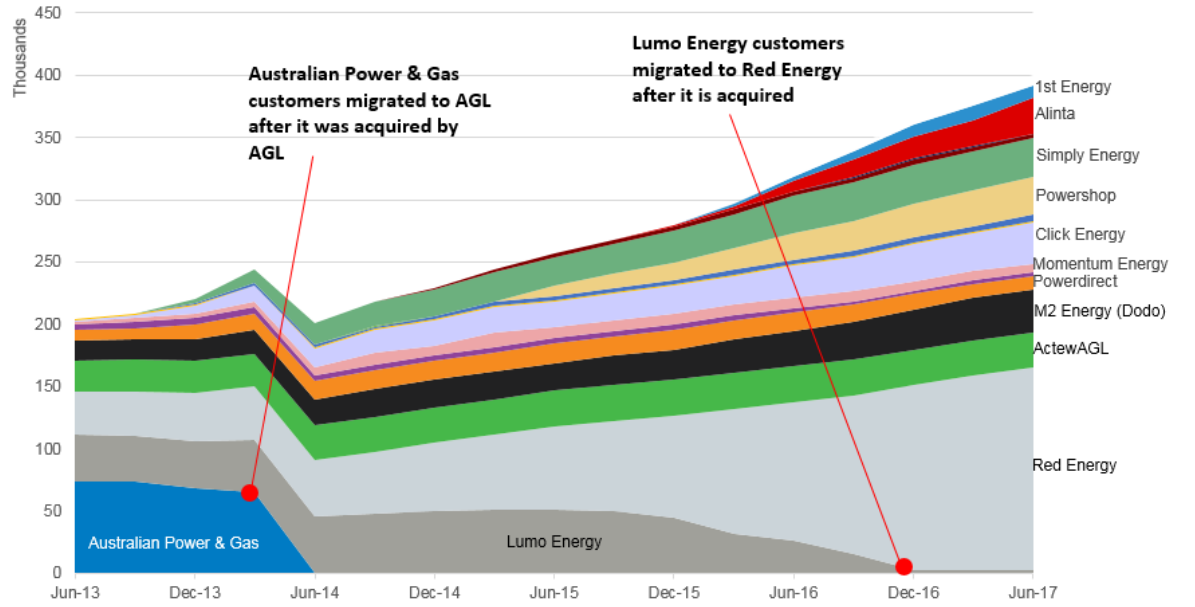
Data source: AER retail statistics https://www.aer.gov.au/retail-markets/retail-statistics/nsw-small-customers, accessed 10 September 2018.

54 AER retail statistics https://www.aer.gov.au/retail-markets/retail-statistics/nsw-small-customers, accessed 10 September 2018.

55 *Ibid.*

56 AER information provided to IPART on 2 November 2017, AGL, Australian Power and Gas Information, https://www.agl.com.au/residential/energy-plans/electricity-and-gas-plans/price-and-contract-information/australian-power-and-gas-information, Information provided to IPART from Red Energy on 11 August 2017.

Figure 3.2 Change in customer numbers for small retailers to June 2017



Note: The smallest retailers do not necessarily show up on this chart. We have only named the largest of the small retailers.

Data source: AER information provided to IPART on 2 November 2017, AGL, *Australian Power and Gas Information*, https://www.agl.com.au/residential/energy-plans/electricity-and-gas-plans/price-and-contract-information/australian-power-and-gas-information, Information provided to IPART from Red Energy on 11 August 2017.

Last year we found that the level of concentration in the retail electricity market is not dissimilar to the market for other widely consumed goods and services being provided in competitive markets that are not price regulated. These include groceries, private health insurance, and telecommunications services, and NSW compulsory third party (CTP) greenslips (Box 3.1). The ACCC has raised concerns with the level of competition in some of these industries, however has not proposed price regulation.[57]

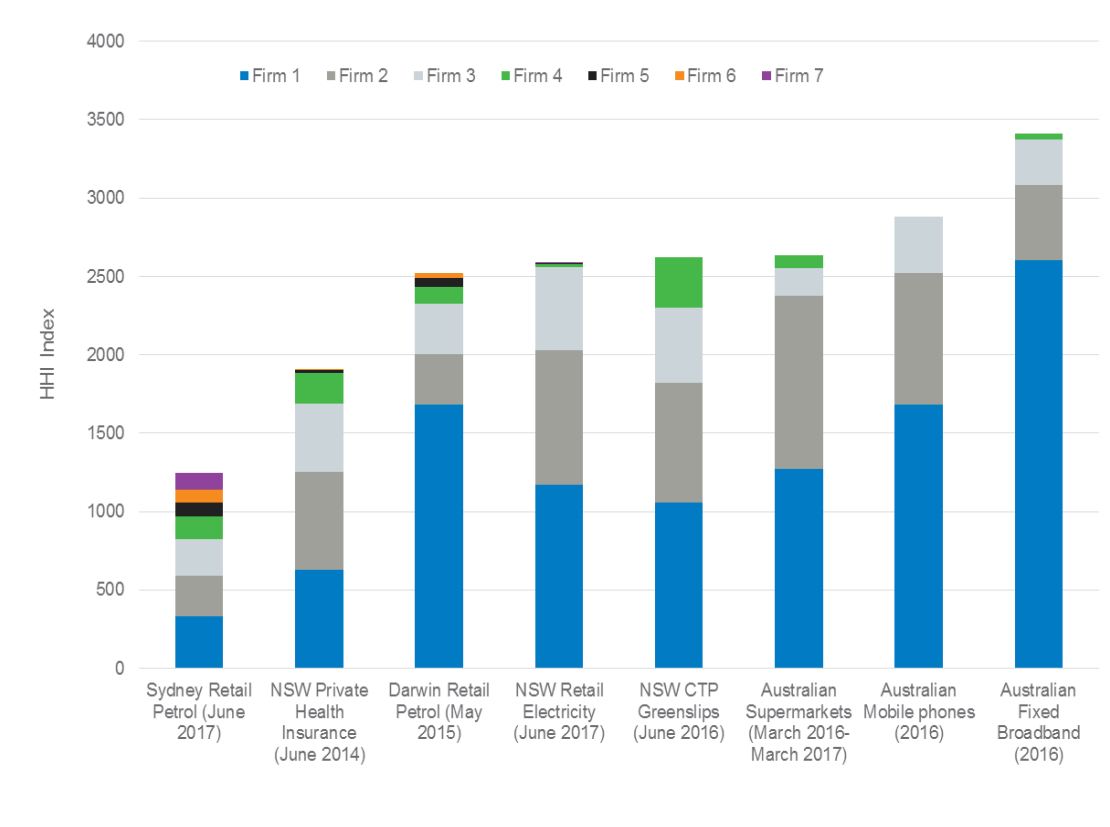
57 For example see: ACCC, *Communications sector market study, Draft Report*, October 2017, p 13.

Box 3.1 Market concentration in different sectors

In our 2017 market monitoring report, we compared the level of market concentration in the retail electricity market to markets for other widely consumed goods and services, by comparing the Herfindahl-Hirschman Index (HHI) for each of these sectors. A higher HHI indicates are more concentrated market.

The HHI for the NSW retail electricity market is around 2,556, which is higher than the Sydney retail petrol market and NSW private health insurance, around the same as CTP Greenslips and supermarkets (and retail petrol in Darwin). However, it is lower than mobile phones and fixed broadband. In the mobile and broadband sectors, the largest market player has 40% and 50% of these markets respectively, while the largest market share in the retail electricity market is Origin's 34%.

HHI and contribution of each firm to HHI by industry (Australia)



Source: IPART, *Review of the performance and competitiveness of the retail electricity market in NSW*, November 2017, pp 45-47.

Note: The HIH is calculated by squaring the market share of each firm competing in a market, and then summing the resulting numbers. A HHI close to zero indicates a very low level of market concentration, while a market with only one firm would have a HHI of 10,000 (100% of the market, squared). The ACCC considers that a HHI of more than 2000 (five firms that each have 20% of the market, or (20)2 + (20)2 + (20)2 + (20)2 + (20)2) indicates a highly concentrated market).

3.3.1 Increasing costs may be discouraging additional entry

The large numbers of retailers operating in NSW suggests that there are no substantial barriers to setting up a retail business in NSW. In its electricity retail pricing inquiry, the ACCC stated that the number of small retailers with very small operations and low levels of capital reinforces the view that barriers to entry in the market are relatively low. It reported that one

small retailer estimated that a 'bare bones' entry into the retail market (excluding Victoria) would cost around $2.5 million.[58]

However, the ACCC and AEMC have found that there are a number of factors that are increasing costs for smaller retailers, including:

- reduced contract market liquidity making it harder for all parties to effectively manage their wholesale price risk,[59]
- inconsistent jurisdictional regulations, and
- increased regulatory and political intervention in the retail market.

Reduced contract liquidity

Each year, the AEMC asks retailers to provide their opinions on barriers to entry and expansion in its retailer survey, including the materiality of any barriers, and whether barriers are specific to particular jurisdictions, or to regional and rural areas.[60]

Like last year, retailers reported that a lack of liquidity in the contracts market is a barrier to entry or expansion for small retailers. Due to their size, small retailers commented that they may not have access to a number of products such as swap and caps as their load is too small. One retailer noted that liquidity has always been an issue in the wholesale contract market, and that it has progressively been getting worse over the past three years.

Effective and efficient hedging markets are a crucial tool for all types of retailers.[61] They provide protection for retailers from volatile and uncertain wholesale spot prices. In the absence of their own generation plant, new retailers (or existing retailers looking to expand) usually need to be able to obtain hedging contracts.[62]

While smaller retailers are currently able to access exchange-traded derivative products to hedge their risk exposure, the ACCC has found that the combination of vertical integration and concentration in the NEM has reduced contract market liquidity and is making it harder for all parties to effectively manage their wholesale price risk. In particular, the cost of access to the ASX has increased, and there are now very few suppliers of load-following hedges. Smaller retailers may therefore find it harder to enter and expand.[63]

However, the ACCC considered that there are few direct interventions that could be made in hedging that would not have other distortionary effects. It considered both retail and wholesale markets are likely to function better in the long term if market forces continue to set prices.[64]

It only found that there was insufficient liquidity in the South Australian Market to warrant changes. In South Australia, it is recommending 'market making obligations' which would require owners of generators to make offers to buy and sell hedge contracts at regular intervals

58 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 149.
59 *Ibid*, p 131.
60 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 30
61 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 150.
62 *Ibid*.
63 *Ibid*, p 150.
64 *Ibid.*

(typically during a specified time window each day). It also noted that should the market making obligation prove to be highly effective in South Australia it may be expanded to include other NEM regions if liquidity concerns are identified.[65]

In other NEM states, the ACCC has only made recommendations to increase transparency in the over-the-counter market, where retailers and generators trade bilaterally. Most retailers indicated through the AEMC survey they currently use a mix of over-the-counter (OTC) contracts and the ASX derivatives market to hedge their risk on the wholesale market. However, some deal exclusively with the OTC market if they have a small load profile. For other small retailers (and their potential trading partners) the costs of bilateral OTC trading can be prohibitive because they are long and complex agreements that can take significant time and cost to put in place.[66]

The ACCC considered that the lack of transparency in the OTC market impedes price signals in the market, and introduces uncertainty for participants and policy makers. Therefore it recommended a requirement for OTC trades to be reported to a registry administered by the AER then published in a de-identified format.[67]

3.3.2 Multiple jurisdictional regulatory regimes drive up costs

The National Energy Customer Framework (NECF) provides consistent retail rules for electricity and gas retailers across the NEM. However, Victoria has opted out of the national framework, and over time, other states and territories have introduced additional rules and requirements, reducing regulatory consistency. NSW has its own requirements for delivering social programs under the NSW Social Programs for Energy Code, and other rules, for example a prohibition on charging for paper bills.

Incremental changes across jurisdictions create costs, as retailers are required to operate under different rules and regulations. A number of retailers reported that this can be a barrier to entry for smaller retailers. This is because it could result in a loss of scale due to different system requirements for each jurisdiction, for example, it may require them to have multiple customer management systems to operate. In its submission to our review, Simply Energy supported greater regulatory harmonisation.[68]

In the AEMC's retailer survey, a number of retailers commented that the NSW Social Programs for Energy Code is a barrier to entry and expansion, because it is an additional jurisdictional requirement outside the National Energy Consumer Framework.[69] Similarly, Simply Energy submitted to our Information Paper that the recent changes to the code would have been better coordinated through a national framework, because a retailer could end up with multiple obligations aimed at achieving the same outcome at both a state and national level.[70] Retailers also suggested the process to implement the recent changes to the code was not straight-forward, particularly due to the retrospective application of the changes.[71]

65 *Ibid.*
66 *Ibid*, p 112.
67 *Ibid*, p 122.
68 Simply Energy submission to IPART Information Paper, August 2018, p 1.
69 AEMC, *2018 Retail energy competition review*, Final Report, 15 June 2018, p 268.
70 Simply Energy submission to IPART Information Paper, August 2018, p 2.
71 AEMC, *2018 Retail energy competition review*, Final Report, 15 June 2018, p 40.

IPART considers that jurisdictions should harmonise their energy customer protection arrangements to minimise the barriers and costs for traditional and new retailers who operate across the NEM.

Political and regulatory intervention

Through the AEMC's retail survey, many retailers noted the unprecedented level of political and media attention on the energy sector, which had resulted in piecemeal approach to policy changes and changes to the market rules. As well as increasing the risk of operating in such an environment, it is also administratively burdensome. It has resulted in consultation processes on related issues not being aligned, and overlapping issues being considered by different regulators.[72]

It has also meant that retailers have been required to provide information to a number of different state-based and federal regulators in response to different work streams, increasing compliance costs. One retailer reported that the cost to service customers resulting from regulatory intervention is increasing more than the cost to acquire customers.[73]

3.4 Barriers to expansion

While there are a large number of retailers competing in NSW, many have a very small number of customers and have been slow to expand their market share. The ACCC found that a key impediment to smaller retailers expanding their customer bases is the aggressive customer retention practices of the large retailers.

Where a customer arranges to switch retailers, it is common for the their previous retailer (the 'losing' retailer) to offer very cheap retention deals, including offers priced well below publicly available offers. For example, the ACCC found that for one of the big three retailers, most of those offers were estimated to generate less than $40 of net present value in the first year, and some offers would not return a positive margin to the retailer in the first year.

A number of retailers estimated that around 20% of newly acquired customers are lost to these retention practices. The ACCC found that retention practices have a disproportionate impact on smaller retailers as the accumulation of substantial wasted acquisition costs are spread across their smaller customer bases through comparatively higher per customer prices, making them less competitive overall. In addition, it found that the smaller retailers tend to acquire a higher proportion of 'lower value' customers as the larger players do not make an effort to retain these customers.[74]

72 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 30.
73 The AEMC noted that it does not have access to data to verify the level of this increase. *Ibid.*
74 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 142-143.

The ACCC considered that in general, retention activity is likely to be pro-competitive. Retention activity provides customers with greater choice and the opportunity to achieve the best possible deal, putting downward pressure on prices. However, in the electricity market, the large retailers have a unique incumbency advantage that allows them to cross-subsidise their retention offers (pricing them potentially below cost) from the higher profits they are earning from their significant number of sticky high value customers (Box 3.2). This ability to rely on retention activities reduces the need for big retailers to proactively give their loyal customers incentives to stay – rather they are likely to be penalised with higher prices. The ACCC reported that in 2016–17, Origin retained around 1.5 million gas and electricity customers, at a cost of more than $100 million dollars, which was three times the number of new customers it acquired in the same year.[75]

Box 3.2 Incumbency advantages of the big three

When the publicly owned retailers were sold, the customer bases were largely acquired by the big three retailers. This means that some of these customers have never switched retailers. By contrast, customers who are supplied by a small retailer have demonstrated a willingness to seek out a better electricity deal at least once. This makes them more likely to switch again if a new retailer does not meet their needs.

The data obtained by the ACCC supports the view that the big three retailers have more customers with very long tenures compared to other retailers. In addition, they have a much higher proportion of their customers based on standing offers (19% compared to 2% for small retailers). This further indicates that these customers have never switched plans, or switch plans infrequently.

In addition, standing offers are typically the most expensive offers in the market, and therefore these customers are likely to be highly profitable. The ACCC found that the average revenue per residential customer is almost $150 or 10% higher for the big three compared to other retailers.

The ACCC found that the stable and profitable nature of their customer bases gives the big three a very strong incentive to retain and maintain their existing customer bases. As a result of their higher margins and cost advantages (because they can spread their costs over a larger customer base), they can cross subsidise retention offers, giving them an advantage in the market.

Source: ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, pp 140-141.

In response to submissions, the ACCC considered a number of options to reduce aggressive retention activities, including:

- banning retailers from engaging in save and/or win back activity, or limiting the extent to which, or manner in which retention offers can be made to customers (for example, limiting how many times a retailer can call a customer),
- ensuring that retention offers are deemed 'generally available', so that these offers must be published on, for example, the Energy Made Easy website, creating transparency in relation to these offers for customers and competing retailers, and
- speeding up the transfer process and/or eliminating the advance notification process to reduce the opportunity for save activity.[76]

The ACCC decided not to limit or prohibit retention activity. This was because it was concerned about unexpected and unintended consequences on the competitive dynamic in

75 *Ibid*, p 143.
76 *Ibid*, p 151.

the market, regulatory complexity, and because similar restrictions that were introduced in New Zealand led to no overall increase in competition in the market. In New Zealand, the retailers replaced their activity relating to 'saves' (where they retain the customer before they switch) with 'win-back' activity (where they 'win-back' the customer after they have switched retailer). However, the ACCC made two recommendations to limit the opportunity for losing retailers to conduct save activity before a customer transfer has taken place.[77]

Firstly, it has recommended that AEMO should amend its rules and procedures so that losing retailers are only given a loss notification on the actual date of transfer of financial responsibility for the customer to the new retailer (at the date of the final meter reading). Currently the old retailer is informed shortly after the retailer change request. One of the reasons for this is to help the old retailer prevent new retailers from fraudulently or erroneously signing up customers, however the AEMC and AEMO data suggests that this occurs infrequently.[78]

It has also made a recommendation for the AEMC to make changes to speed up the customer transfer process, for example by enabling customers to use self-reads of their electricity meters. The average transfer time in the NEM (excluding Victoria) was at just over 30 calendar days in 2015, and transfers can currently be delayed considerably if the new retailer does not elect to obtain a special meter read (given that manual meter reads only usually take place every three months). Over time the roll-out of smart meters will eliminate the need for manual meter reads and speed up this process.[79]

Draft Finding

1 There are no substantial barriers to setting up a retail business in the NSW electricity market. However new retailers may face increased economic barriers that would require them to have considerable financial capacity to gain market share due to:

- reduced contract market liquidity making it harder for retailers to effectively manage their wholesale price risk
- inconsistent jurisdictional regulations; and
- increased regulatory and political invention in the energy market.

3.5 There are nine retailers active in the NSW gas market

As noted in Section 3.2, of 24 electricity retailers currently active, nine also provide gas retail services in NSW (under 12 brands). This is up from 4 gas retailers (under 5 brands) in 2013.[80]

Three of these retailers have entered the market following price deregulation in July 2017[81]: Simply Energy, Alinta, and Amaysim. After acquiring Click Energy in 2017, Amaysim is offering retail gas services under both the Amaysim and Click brands to residential customers (but only under its Click brand to business customers).

77 *Ibid.*
78 *Ibid,* pp 152-153.
79 *Ibid,* p 153.
80 AEMC, *2018 Retail energy competition review,* Final Report, 15 June 2018, pp 268, 274.
81 *Ibid*, p 43.

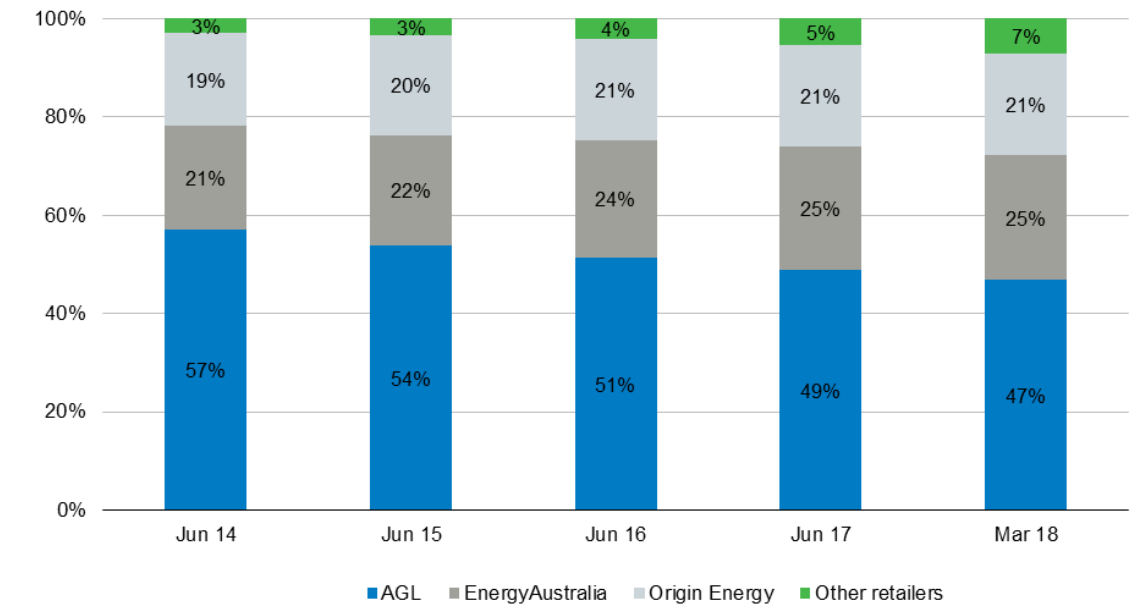
All of the gas retailers are also active in the electricity retail market, however Simply Energy is the only retailer that only supplies gas to customers who also have an electricity account with them (under a dual-fuel contract).

Over 2017-18, the concentration in the gas market continued to decrease, continuing a consistent trend of smaller retailers gaining market share at the expense of the big three retailers in NSW.[82] Figure 3.3 shows that in June 2014, smaller retailers supplied only 3% of the market for small customers, this has grown to about 7% in the June 2018 quarter.[83]

As at the end of March 2018, the big three retailers had around 93% share of the NSW electricity market for small customers, made up of:

- AGL (47%)
- EnergyAustralia (25%), and
- Origin Energy (21%).[84]

Figure 3.3 Change in gas retailers' market share for all small customers



Data source: AER, *Retail performance statistics*, https://www.aer.gov.au/retail-markets/retail-statistics/nsw-small-customers, accessed 10 September 2018.

82 The Herfindahl-Hirschman Index (HIH) reduced by 220 points to 3,599. The market concentration in the retail gas industry is higher than for electricity (2,556). The HIH calculated by squaring the market share of each firm competing in a market, and then summing the resulting numbers. A HHI close to zero indicates a very low level of market concentration, while a market with only one firm would have a HHI of 10,000 (100% of the market, squared). The ACCC considers that a HHI of more than 2000 (five firms that each have 20% of the market, or (20)2 + (20)2 + (20)2 + (20)2 + (20)2) indicates a highly concentrated market). ACCC, Merger Guidelines, November 2008, p 35. AEMC, *2018 Retail energy competition review,* Final Report, 15 June 2018, pp 268, 270

83 *Ibid.*

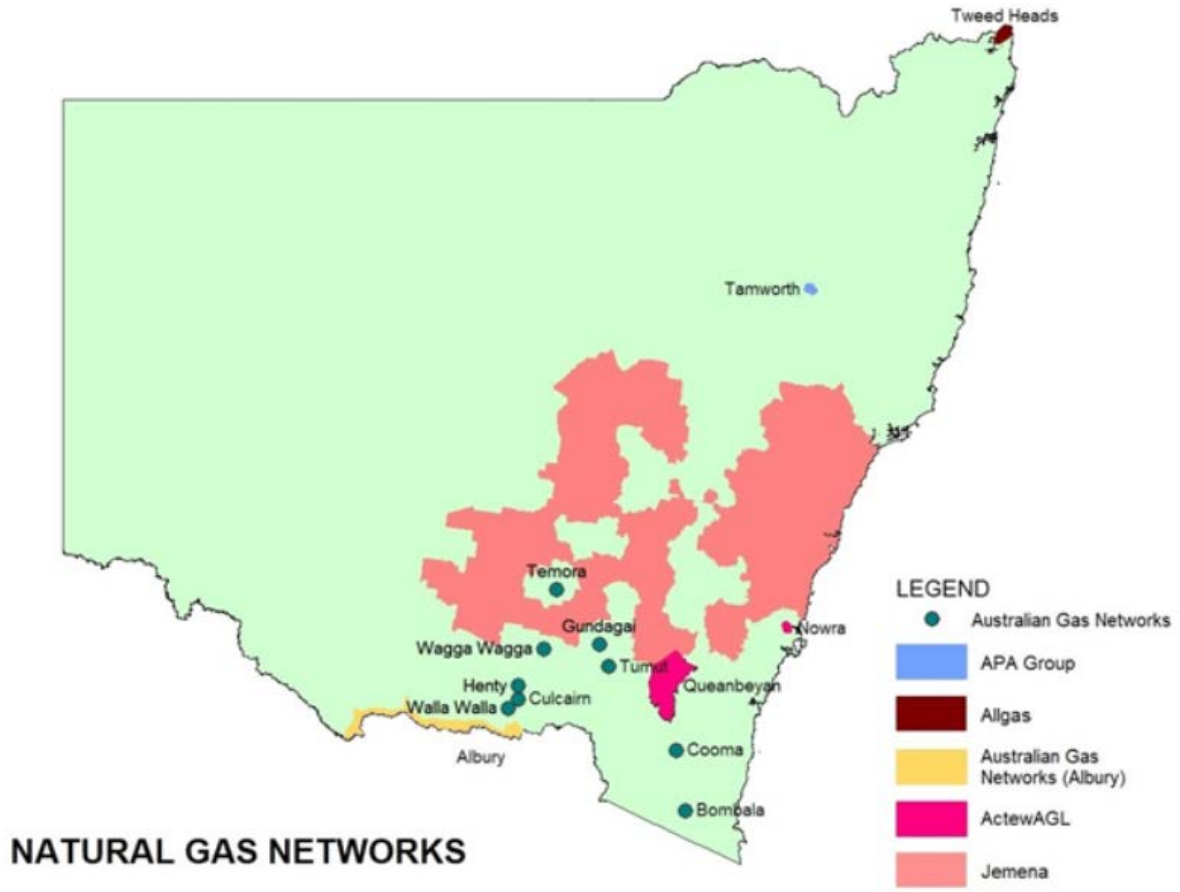
84 AER retail statistics https://www.aer.gov.au/retail-markets/retail-statistics/nsw-small-customers, accessed 10 September 2018.

3.6 The number of active gas retailers varies by network area

While the number of gas retailers continues to grow across NSW and the level of concentration is falling, there are different distribution networks across NSW (Figure 3.4), and not all of the retailers are active in each of these (Table 3.2).

Of the 1.4 million[85] gas customers in NSW, 1.3 million of these are located in the Jemena network, covering Sydney, Newcastle, the Central Coast and Wollongong, and regional centres in the Central West, Central Tablelands, South Western, Southern Tablelands, Riverina and Southern Highlands regions.[86] Except for ActewAGL, all gas retailers are active in the Jemena network supplying residential customers. Of the eight retailers active in the Jemena network, only two are not supplying business customers: Alinta and Dodo.

Figure 3.4 Gas networks in NSW



Data source: NSW Planning & Environment, *Gas Connections*, https://www.energy.nsw.gov.au/energy-consumers/energy-providers/household-gas-connections, accessed 25 September 2018.

85 AER, https://www.aer.gov.au/retail-markets/retail-statistics/nsw-small-customers, accessed 10 September 2018.

86 Jemena, *Jemena Gas Network,* http://jemena.com.au/about/what-we-own/our-assets/jemena-gas-network, visited on 10 September 2018.

Outside of the Jemena network, only Origin, AGL, EnergyAustralia, Red Energy, and Actew AGL are active in the gas market. Up to three of these retailers are active in any given network. The Shoalhaven and Tamworth regions are only supplied by one retailer – ActewAGL and Origin Energy respectively.

In the networks in which they are active, retailers are supplying gas to both business and residential customers. The only exception is in Wagga Wagga, where EnergyAustralia is supplying residential customers, but not gas business customers.[87]

Table 3.2 Gas retailers in NSW by network area

	Retailer	Jemena	Wagga Wagga	Albury	Murray Valley	Tamworth	Shoalhaven	Queanbeyan	Temora	Gundagai	Cooma Bombala	Tweed Heads
Customer numbers	**1.4 m**	**1.3 m**										
1	Origin Energy	X	X	X	X	X		X	X	X	X	X
2	EnergyAustralia	X	X	X	X			X				
3	AGL	X	X	X	X				X	X		X
	ActewAGL						X	X				
4	Red Energy	X								X	X	
	Lumo Energy	X										
5	Alinta Energy	X										
6	Amaysim	X										
	Click Energy	X										
7	Dodo Power and Gas	X										
8	Covau	X										
9	Simply Energy	X										
Total retailers		9	3	3	3	1	1	3	2	3	2	2

Source: Energy Made Easy.

3.7 High wholesale prices might be deterring further entry

As noted above, there have been three new entrants to the Jemena region in the last year, and it is anticipated that Royal Dutch Shell may enter into the retail gas market as part of expanding its business beyond commercial and industrial customers.[88]

However, the responses to the AEMC's retailer survey suggest that while gas is available, high wholesale prices are currently deterring retailers from entering the market. Vertical

87 Energy Made Easy.
88 AEMC, *2018 Retail energy competition review*, Final Report, 15 June 2018, p 43.

integration is less common in the gas sector than for electricity (with only Origin and AGL having upstream assets) so access to gas contracts is necessary.[89]

The AEMC found that as a result of high wholesale prices, many smaller electricity retailers said that they were not looking to expand into the gas market. They claimed that it can take a long time to organise gas agreements.

One retailer commented that financial products are less prevalent in gas and therefore it is unable to manage its risk through financial or physical contracts. That retailer also suggested that gas contracts are usually long-term, but given the flux in the market, it is unsure if it will be able to sell the gas purchased.

One retailer reported that while more gas contracts have become available since the federal Government announced it may restrict the export of gas to ensure domestic supply, there is a still a risk of being able to get access to gas contracts in New South Wales.[90]

In regional areas, the limited geographical coverage of the networks means that the customer base may be too small to warrant entry or geographic expansion, particularly given the fixed cost nature of gas transportation services. The need to negotiate access to pipelines contributes to higher fixed costs to enter the retail gas market relative to the retail electricity market. These factors might deter some retailers from entering regional gas markets and would most likely mean that over the long term fewer retailers compete for small gas customers in regional areas, relative to metropolitan areas. However even where there are only one or two retailers active, the threat of competition can be effective at protecting customers.

When we previously reviewed competition in 2016, we also found that the capacity of some regional pipelines had been fully contracted by a single retailer or a small number of retailers under long-term contracts and the cost of expanding capacity for what is likely to be a relatively small customer base may not be justified.[91]

Draft Finding

2 There are no substantial barriers to setting up a retail business in the NSW gas market. However, higher wholesale prices and access to pipeline capacity may increase the economic barriers, which means that a new retailer needs considerable financial capacity to gain market share.

89 AEMC, *2018 Retail energy competition review,* Final Report, p 43-44.
90 *Ibid,* pp 46-47.
91 IPART, *Review of regulated retail prices and charges for gas from 1 July 2016*, June 2016, p 22.

4 Retailers are competing to attract and retain customers

One of the characteristics of a competitive market is strong rivalry between retailers. Where this rivalry exists, retailers attempt to outcompete each other by making more attractive market offers and differentiating their products and services to target different customers' needs.

To assess the level of rivalry between retailers in 2017-18, we examined the range of market offers, products and services available to small customers in NSW. The sections below outline our draft findings, and then discuss them in more detail.

4.1 Overview of draft findings

We have found that there is evidence of rivalry between retailers, who primarily compete on price. Discounting continues to be the main way that retailers compete to attract customers. Retailers are also competing on products for example, bundling services, offering rewards such as frequent flyer points, and using solar feed-in tariffs to attract customers. There are also an increasing number of retailers that market themselves as sustainable or 'green' energy providers. Price variation is consistent with a competitive retail market, and supports innovation and dynamic efficiency.

4.2 There is a wide spread of generally available offers

Residential and small business energy plans are either a standing offer or a market offer. All retailers must have a 'standing' offer in the regions that they are active. A standing or standard offer contract contains terms and conditions including:

- retailers must inform customers about price increases
- prices cannot change more than once every six months, and
- there is a minimum amount of time before customers can be disconnected if they do not pay their bill.[92]

Generally, a retailer's standing offer will be its highest offer.

Figure 4.1 shows the spread of residential electricity bills in the market as at the end of July 2018 for a typical customer using 5,100 kWh per year. It shows the differences in retailers' prices, and also the difference between the lowest offer and the standing offer for each retailer.

In previous years, we have calculated electricity bill for a typical customer using 6,500 kWh per year. However, this year we have updated the consumption of a typical customer based on the 2017 survey for the AER's electricity and gas bill benchmarks for residential

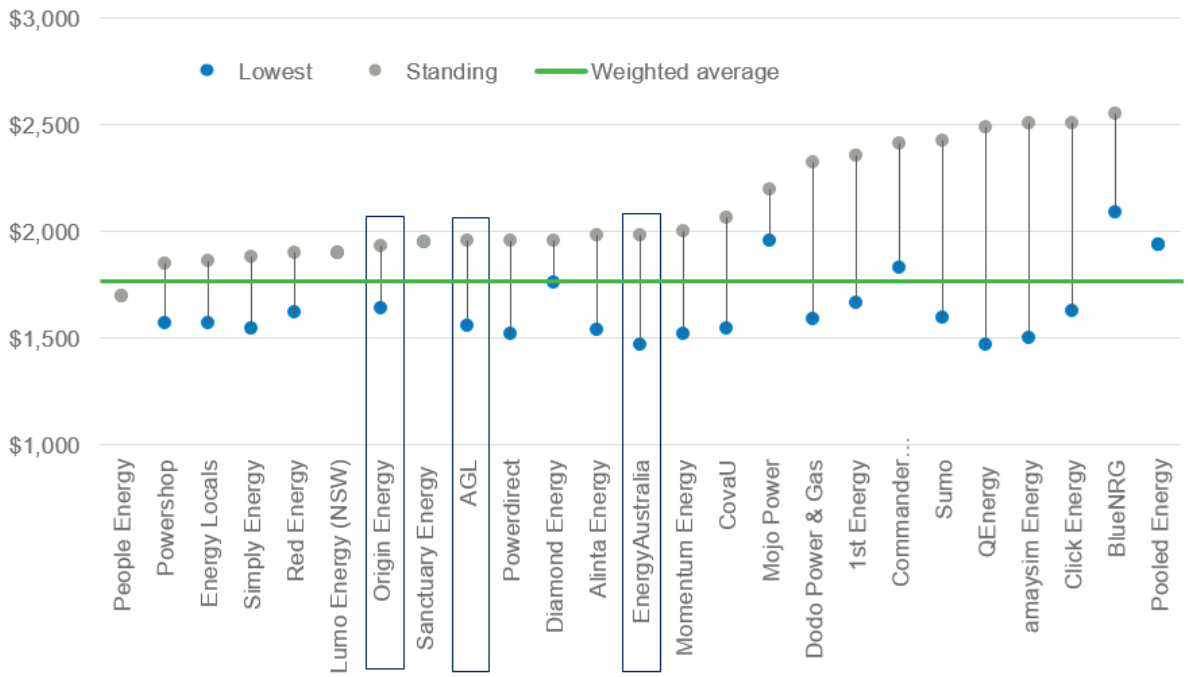
92 AEMC, *2018 Retail energy competition review*, Final Report, 15 June 2018, p 49.

customers.[93] The survey showed falling annual consumption across almost all jurisdictions since it was first conducted in 2011.[94]

Figure 4.1 shows that the standing offers for many of the smaller retailers are significantly higher than the standing offers for the big three retailers. The difference between the standing and lowest offers for smaller retailers was 34% on average, while for the big three retailers, the average difference between them was 26%.

We also found that the most expensive electricity offer is around 70% higher than the cheapest on offer.

Figure 4.1 Electricity offers for residential customers (Based on the Ausgrid network, 5,100 kWh pa, GST-inclusive, after discounts)



c Data source: Energy Made Easy.

d Note: As at September 2018. The standing offer for Pooled Energy was not available on the Energy Made Easy website.

e

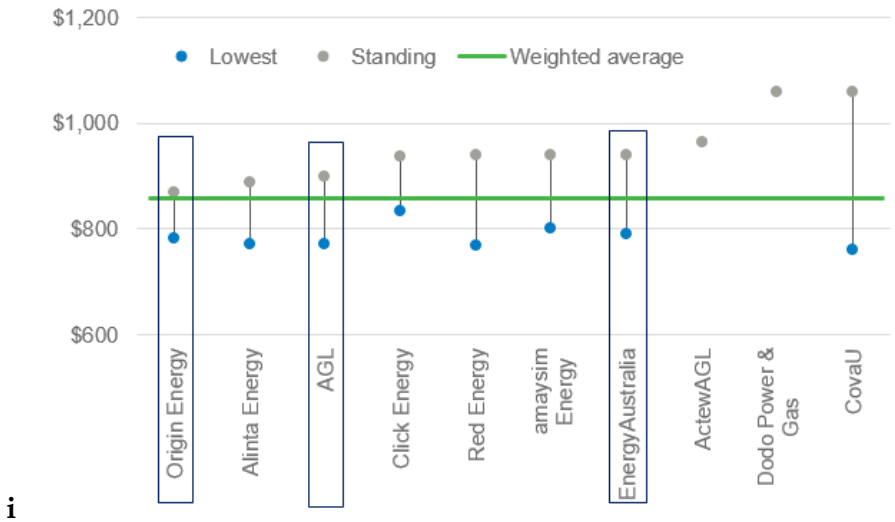
f The spread of prices in the residential gas market is similar to that for electricity. Figure 4.2 shows that on average, the difference between the lowest offers and standing offers across gas retailers is around 20%, or around $170 for a typical customer.

g

h Figure 4.2 also shows that the range of prices in the gas market is smaller than the electricity market. The highest price offer in the gas market is around 35% higher than the least expensive.

93 ACIL Allen, *Energy Consumption Benchmarks, Report to Australian Energy Regulator,* October 2017, p 26.
94 *Ibid,* p V.

Figure 4.2 Gas offers for residential customers (Based on the Jemena network, 20,000 MJ pa, GST-inclusive, after discounts)



i

j

k **Data source:** Energy Made Easy.

l **Note:** As at September 2018.

4.2.1 Discounting continues to be a common practice

Setting a higher standing offer allows retailers to advertise large discounts from them. Retailers usually offer discounts from their standing offer rates[95] and a new rule was made in 2018 that retailers cannot advertise discounts off offers that are higher than the standing offer.[96]

Undiscounted products are becoming more common, but discounting continues to be the main way that retailers compete for customers, and these headline discounts are becoming higher. As of July 2018, only 20 per cent of gas and electricity market offers across the NEM states have no discounts attached to them.[97]

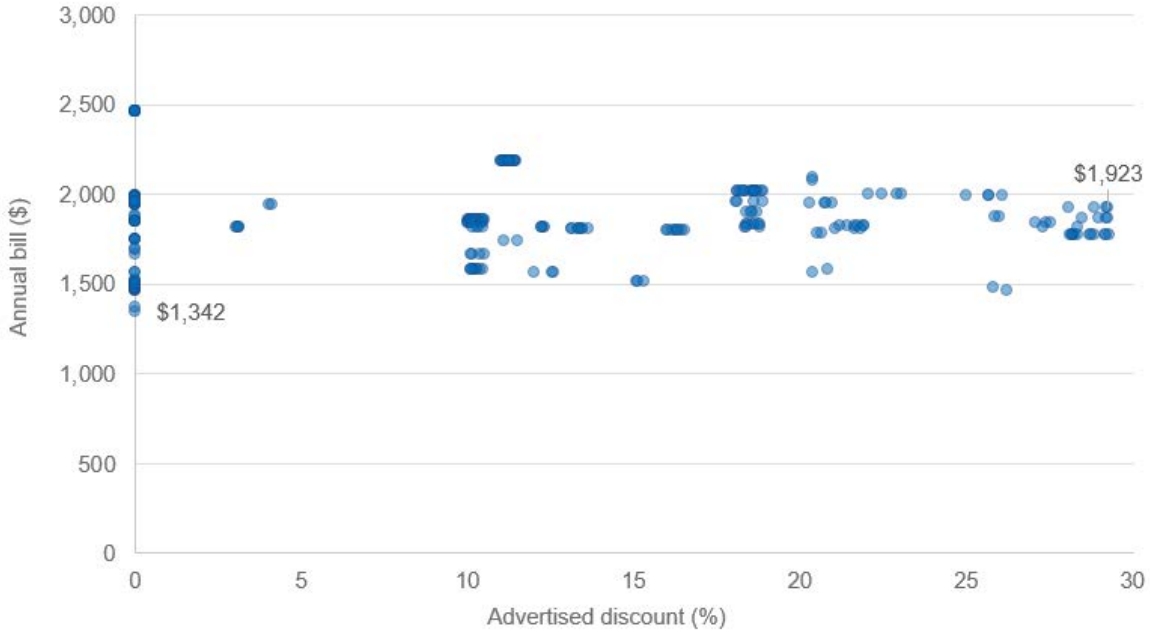
Some retailers apply their discounts to the whole bill, and others apply it just to the usage component of the bill. During 2017-18 the highest advertised discounts in NSW were 35% off the total bill (up from 20% in 2016-17), and 32% off usage rates (up from 27%).[98]

For gas, the highest advertised discounts were 20% of the total bill (up from 18% in 2016-17), and 25% of usage rates (up from 20% in 2016-17).[99]

However, higher advertised discounts often reflect higher underlying prices, rather than a better deal for customers. Figure 4.3 shows there is a little correlation between discount size and total bill. One of the cheapest offers in the market has no discounts, and an offer with a 30% discount results in one of the highest bills.

95 AEMC, *2018 Retail energy competition review,* Final Report, June 2018, pp 54-55.
96 AEMC, *Preventing discounts on inflated energy rates,* https://www.aemc.gov.au/rule-changes/preventing-discounts-on-inflated-energy-rates, accessed 27 September 2018.
97 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 54.
98 *Ibid,* p 57.
99 *Ibid,* pp 57-58.

Figure 4.3 Annual bill by advertised discount – Endeavour network (Based on the Ausgrid network, 5,100 kWh pa, GST-inclusive, after discounts)



Data source: Published offers on Energy Made Easy as at September 2018.

While discounts are a poor indication of value, retailers have indicated that it is still one of the most effective ways to attract customers, and moving away from discounting is likely to result in losing customers in the short term.[100] However, as mentioned above, as more customer are becoming aware that discounting does not necessarily lead to lower bills, many retailers are also marketing '0% discount' low price offers.[101]

4.2.2 Most discounts are conditional

The majority of discounted products are also conditional on customers meeting certain requirements. Around 60% of all market offers in the NEM have at least one conditional discount, and only 25% of offers had discounts that were not conditional.[102]

The most common condition is that the customer pays their bill on time. They can also be conditional on only receiving bills online, paying by direct debit, and having multiple accounts with the retailer. One retailer, 1st Energy, also now offers a discount to a customer on the condition they do not switch away (i.e. "If you change retailer at your current supply address, there will be no discount on the final bill").[103]

If the customer does not meet the discounting condition, for example, if they do not pay their bill on time, then the discount will not be applied. This means even though only a relatively small proportion of customer are on standing offers (see Chapter 5 for more information), a portion of them will still pay the higher standing offer rates.[104]

100 *Ibid*, p 63.
101 Offered by Momentum Energy, Energy Locals, Pooled Energy, Mojo Power, ERM Power, AGL and Lumo Energy. *Ibid*, p 64.
102 *Ibid*, p 54.
103 *Ibid*, p 55.
104 *Ibid*, p 56.

4.2.3 Pricing for different customer segments

Electricity and gas offers are made up of a number of different tariff components, including a supply charge, and different consumption charges. For electricity customers with interval or smart meters, retailers can also price usage differently depending on the time that the energy is used, with different prices for energy that is consumed in peak, shoulder, and off peak times.

Customers with different usage profiles will be better off on different types of offers. For example, a low consumption customer might be better off with a lower fixed tariff, and higher prices for consumption, while a customer that uses a lot of energy might be better off with lower usage rates and a relatively higher fixed charge. Similarly retailers can make offers more attractive for customers that use their energy at different types of the day.

In a highly competitive market, we would expect to see retailers tailoring their offers to these different household characteristics. PIAC submitted to IPART's Information Paper that the AEMC found that price dispersion is driven primarily by discounting practices rather than market segmentation.[105] We agree that discounting is the main form of rivalry, but there is some evidence that retailers are tailoring their products for different customer types. For example, Mojo Power's subscription model for electricity customers has higher fixed charges and lower usage rates, and has indicated this plan is suited to medium to high energy users.[106]

There are also examples of locked in rates for customers who value bill predictability. For example, EnergyAustralia's Secure Saver plan guarantees residential electricity and gas customers their usage rates and supply charges will not increase for a two year period.[107]

In addition to combining different tariffs and discounts to create different market offers, retailers also have different fees and charges that can materially change the value of an offer depending on a customer's circumstances. For example, the range of moving out fees varies from around $10 to $170 in the Ausgrid network.[108]

4.2.4 Innovative energy pricing models

Retailers are also starting to appeal to different market segments by offering alternatives to traditional tariff structures.

For example, for customers who value predictability of their energy bills, Origin Energy is offering a 'predictable plan' that guarantees a residential electricity or gas customer a fixed bill amount per month (based on their individual circumstances) for a 12-month period irrespective of monthly variations in usage.[109]

105 PIAC submission to IPART Information Paper, August 2018, p 1.
106 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 54.
107 EnergyAustralia, *Secure Saver,* https://www.energyaustralia.com.au/home/electricity-and-gas/understand-electricity-and-gas-plans/secure-saver, accessed 27 September 2018.
108 Energy Made Easy.
109 Origin, *Predictable Plan,* https://www.originenergy.com.au/for-home/campaign/origin-predictable-plan.html, accessed 20 September 2018.

The Australian Energy Council submitted that many smaller retailers in the market are at the forefront of innovation and are providing improved offering to customers.[110] For example, Powershop allows customers to pre-purchase units of energy when it is convenient and offers periodic sales and discounts.[111]

These type of pricing structures are in their infancy, but the take-up of smart meters will enable retailers to develop new pricing models, as energy consumption is measured in real time.

4.3 Retailers are also differentiating their product offerings

As well as an increasing range of prices being offered to customers, products and services have also become more varied, particularly as technology continues to develop. Sign up incentives (such as bill credits when they refer a customer[112]), movie tickets, airline points[113] and retailer-specific reward schemes are common.[114] It is common for retailers to offer electricity and gas together.[115]

More retailers have started to offer digital meters, solar PV, and battery options to their customers, in addition to traditional energy services.[116] For example, EnergyAustralia and Origin Energy offered solar panels, inverter and installation, as well as battery storage systems.[117] Enova Energy is also planning to develop options to make solar take up attractive to landlords and renters.[118] It is also becoming more common for retailers to provide customers with information about their electricity usage through an app.[119]

The opportunities for product innovation will continue to increase over time, as smart meters allow the value of the energy that is being fed into the grid by households to be captured in real time, and issues around the reliability of supply is making customer demand response (customers agreeing not to use energy) more valuable at the same time as the take up of digital meters is increasing.

Draft Finding

3 There is evidence of rivalry between energy retailers who are offering a large range of prices, and a growing range of products and services.

110 Australian Energy Council submission to IPART Information Paper, August 2018, p 1.
111 Powershop, *Powerpacks, https://www.powershop.com.au/powerpacks/*, accessed 27 September 2018.
112 Diamond Energy, *Refer a friend and both receive $35 credit!*, http://diamondenergy.com.au/diamond-referral/, accessed 27 September 2018.
113 For example, see Red Energy, Earn Qantas Points for being a Red Energy customer. https://www.redenergy.com.au/qantas/, accessed 27 September 2018.
114 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 68.
115 For example see Dodo, *About Dodo Power and Gas,* http://www.dodo.com/power-gas/quick-links/about-dodo-power-gas/, accessed 27 September 2018.
116 However, we note that in the AEMC's retail survey, some retailers reported that the NSW Government's moratorium on remote connections and disconnections of smart meters is limiting innovation in New South Wales, AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 40.
117 EnergyAustralia*, Solar Power Systems,* https://www.energyaustralia.com.au/home/solar-and-batteries/solar-power/solar-power-systems, accessed 27 September 2018.
118 Enova Energy*, About Enova*, https://enovaenergy.com.au/about-us/, accessed 27 September, 2018.
119 For example, see Powershop, *Powershop App*, https://www.powershop.com.au/powershop-app/, accessed 27 September 2018, AGL, Wondering about your energy usage? https://www.agl.com.au/help/managing-my-account/agl-energy-app, accessed 27 September, 2018.

5 Customers are relatively engaged and active

In markets where competition is working well, we would expect most customers to be engaged and active in the market. For example, they would be aware of the choices available to them and be shopping around for better deals. And the more well-informed and engaged customers are, the more pressure there is on retailers to offer competitive prices and services.

To assess customer engagement and activity in the retail electricity market in 2017-18, we considered awareness of retail competition, switching rates (for the most recent calendar year), and customers' contract types. We also examined the reasons why some customers do not participate in the market. The sections below outline our draft findings and then discuss them in more detail.

5.1 Overview of draft findings

Compared to other countries around the world, customers in Australia are relatively engaged in the energy market.[120] In NSW, we found that customers are relatively engaged and active in the electricity retail market. Switching rates are relatively high, with 19% of customers switching their electricity retailer in 2017, and 14% switching gas retailers.[121]

Some customers choose not to participate or be active in the market because they are satisfied with their current retailer, or because the cost of their time to search for and switch to a cheaper deal outweighs their potential benefit from a lower bill. For these people not participating in the market is a rational choice. However, some customers find it difficult to compare offers and work out if they are on the best available offer. Compared to last year, the proportion of customers who are confident that they are able to find the best deal for them has fallen.

5.2 Customer participation in the electricity market remains high

Almost all customers are aware that they can choose their retailer. The most recent consumer research commissioned by the AEMC found that in 2017, 94% of residential customers and 95% of small business customers in NSW are aware they can choose their retailer.[122]

One of the ways that customers can engage in the market is by switching retailers. In 2017, 19% of residential electricity customers switched retailers, which is up slightly compared to the proportion of customers who switched in the previous years (16% switched in 2015, and 17% of customers switched in 2016) (Table 5.1).[123]

120 Oxera, *Behavioural insights into Australian retail energy markets – Report for the Australian Energy Market Commission*, 11 March 2016, p 27.
121 AEMC, *2018 Retail energy competition review*, Final report, June 2018, pp 97, 271.
122 Newgate Research, *Consumer research for the Australian Energy Market Commission's 2017 retail competition review*, April 2017, p 104.
123 AEMC, *2018 Retail energy competition review*, Final report, June 2018, pp 97-98.

This year the AEMC did not report on the number of customers that switched plan with the same retailer. However, this has tended to remain fairly constant between years at just under 20%.[124]

These switching rates for electricity providers are high compared to other products and services. Compared to the 39% of consumers surveyed that switched electricity providers in the last five years to 2017, 36% switched car insurers, and 34% switched their mobile providers.[125]

Table 5.1 Summary of participation indicators

Category	Customer type	Measure	2014	2015	2016	2017
Awareness	Residential	Of choice of retailer	90%	89%	92%	94%
		Of choice of plans	NA	81%	82%	86%
	Business	Of choice of retailer	86%	95%	92%	95%
		Of choice of plans	NA	87%	86%	81%
Customer activity	Residential	Switching company at least once[a]	15%	16%	17%	19%
		Switching plan with same company	NA	18%	15%	19%
	Business	Switching company at least once	NA	17%	12%[a]	19%[a]
		Switching plan with same company	NA	20%	15%[a]	11%[a]

[a] Updated data from AEMC, *2018 Retail energy competition review*, Final Report, June 2018, pp 97-98, 121. Remaining data comes from source below.

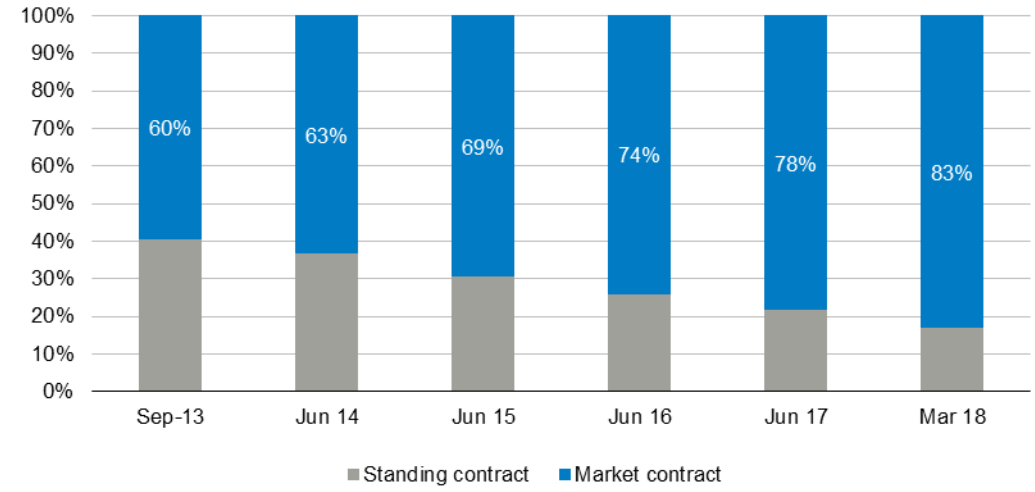
Data source: Newgate Research, *Consumer research for the Australian Energy Market Commission's 2017 retail competition review*, April 2017, pp 102-116.

The change in the proportion of customers on standing and market offers also provides evidence of switching. Standing offers are the default offers for customer who have not engaged in the market at their current supply address. Some of these customers may also have been previously on a market offer that has expired. However, it is uncommon for market offers to expire (instead, many offers have a 'fixed benefit period' and customers will remain on the market offer when this expires).

Figure 5.1 shows that there has been a substantial increase in the number of customers on market offers rather than a 'standing' or default offer since June 2017. 83% of all customers were on a market offer as at March 2018, up from 78% in June 2017. This jump in the number of customers on market offers is likely to reflect increased engagement in the market, following substantial media attention and political intervention in the market. For example, in August last year, the Prime Minister reached an agreement with seven retailers that they would write to all of their standing-offer customers and inform them of their cheaper offers.[126]

124 Newgate Research, *Consumer Research for the Australian Energy Market Commission's 2017 Retail Competition Review*, April 2017, p 106.
125 AEMC, *2017 Retail energy competition review,* Final Report, July 2017, p ii.
126 AEMC, *2018 Retail energy competition review,* Final Report, June 2018, p 50.

Figure 5.1 Proportion of standing and market contracts in NSW



Data source: AER, NSW – Small retail customer contract types, accessed 10 September 2018.

5.3 More customers are participating in the gas market

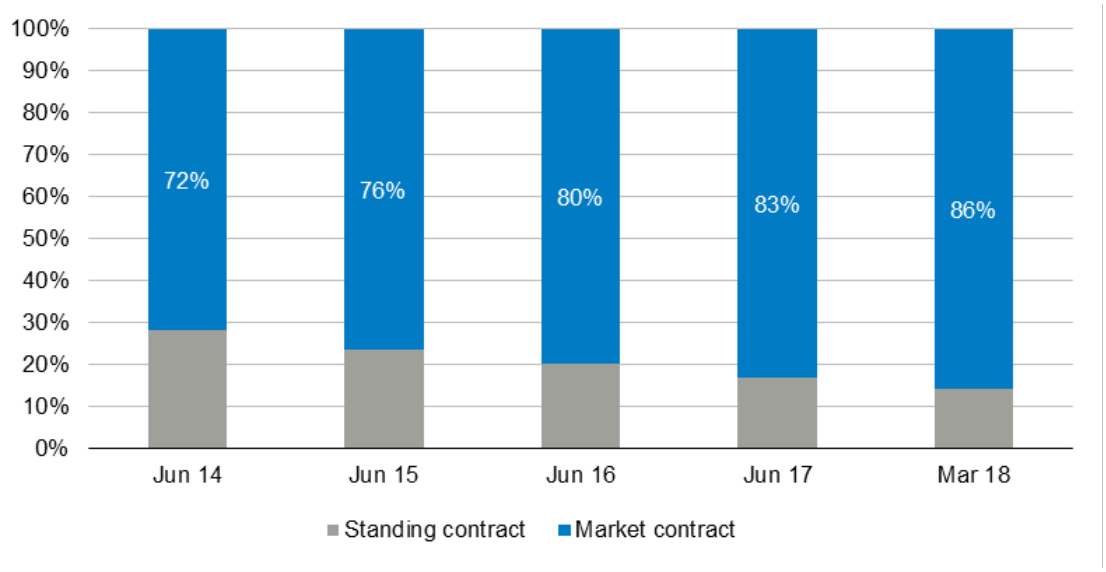
PIAC submitted that there is little incentive for gas retailers to innovate or compete on price, as they do not face the competitive pressures associated with regular customer switching.[127]

We found that switching rates for gas customer is lower than it is for electricity customers. Over the past four years, around 10% of gas customers have switched retailers each year.[128] However, it was higher in 2017 than it has been in other years, at 14% (up from 9.8% in 2016).[129] This was the second highest switching rate for gas customers in the NEM.[130]

Figure 5.2 shows that 86% of all customers are on a market offer, rather than a 'standing' or default offer. This is up from 83% last year before prices were deregulated.[131]

127 PIAC submission to IPART Information Paper, August 2018, p 3.
128 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 98.
129 *Ibid*, p 271.
130 *Ibid*, p 83.
131 AER, NSW – Small retail customer contract types, https://www.aer.gov.au/retail-markets/retail-statistics/nsw-small-customer-contract-types, accessed 10 September 2018.

Figure 5.2 Proportion of standing and market contracts in NSW



Data source: AER, NSW – Small retail customer contract types, https://www.aer.gov.au/retail-markets/retail-statistics/nsw-small-customer-contract-types, accessed 10 September 2018.

5.4 Factors affecting the level of customer engagement

For the past few years, only around 20% of residential customers reported that they are intending to switch retailer in the next 12 months.[132] For many of these customers, not participating in the market is a rational choice. For example, many customers do not participate in the market because they are satisfied with their current retailer. In 2017, the AEMC found a key reason that customers across the NEM had not investigated switching retailers was because they were happy with their current retailer (29% of residential and 25% of business customers who have not investigated switching).[133]

For other customers, the cost of their time to search for and switch to a cheaper deal outweighs their potential benefit from a lower bill. In its 2017 competition review, the AEMC found that 22% of business customers, and 15% of residential customers didn't investigate switching because they didn't have time. Similarly, 14% of residential and 10% of business customers felt it was too much hassle or couldn't be bothered.[134]

It found that the main motivation for customers to switch retailer or plan was to reduce their bill,[135] but customers said that to seriously consider switching retailer or plan, they wanted to save an average of $388 per year on their electricity bill.[136] This year the AEMC found that small business customers wanted to save about $1,284 on their yearly electricity bill ($488 more than last year).[137]

132 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 100.
133 Newgate Research, *Consumer Research for the Australian Energy Market Commission's 2017 Retail Competition Review*, April 2017, p 39.
134 *Ibid*.
135 *Ibid*, p 38.
136 *Ibid*, pp 46-47.
137 *Ibid*, pp 46-47, AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 124.

While a large portion of customers do not switch retailers because they are satisfied with their current retailer, or did not have time, there are also barriers to engagement for some customers. Many customers find it difficult to compare offers, and the proportion of customers reporting that they are not confident that they will be able to find the required information to choose the best offer for their circumstances has increased.

Other customers are not prompted to engage in the market because they are not aware that their prices have changed. However, from February 2018 new rules commenced that require retailers to notify electricity and gas customers when their discount will end.[138] The AEMC has also made a rule to apply from 1 February 2019 that places an obligation on retailers to notify their customers of any price changes in advance (currently retailers are not required to notify customers of prices changes until after they have taken place, and often these notifications are not obvious).[139]

Following a rule change request in June 2018, the AEMC will also consider whether to introduce an obligation on retailers to write to their standing offer customers every 12 months to inform them that there are cheaper offers in the market.[140] Following several roundtable meetings with the Prime Minister in August 2017, many of the retailers did this voluntarily last year.

5.4.1 Some customers find it difficult to compare offers

In its most recent consumer survey, the AEMC found that 8% of residential customers across the NEM reported that the reason they investigated switching offers but did not, was because it was too confusing.[141] It found that residential customers also thought the process is more complex than comparing and selecting other services, such as home/car/health insurance, internet and telecommunication plans, or banking services.[142]

Because electricity offers are made up of a number of different tariff components, including a supply charge, different consumption charges that sometimes vary by time of day, and discounts (which can be applied to some or each of these components) it can be very difficult to compare offers. As discussed in Chapter 4, customers cannot rely on headline discounts to compare offers, because the base rate from which the discounts apply vary across retailers and plans.

An individual stakeholder to our review submitted that retailers do not make it easy to find out what the discount is being compared to. It stated that customers assume that they get the advertised percentage discount off their current prices.[143]

138 AEMC, *Notification of end of fixed benefit period*, https://www.aemc.gov.au/rule-changes/notification-of-end-of-fixed-benefit-period, accessed 26 September 2018.
139 AEMC, *Advance notice of price changes*, https://www.aemc.gov.au/rule-changes/advance-notice-price-changes, accessed 27 September 2018.
140 AEMC, *Long term standing offer notice*, https://www.aemc.gov.au/rule-changes/long-term-standing-offer-notice, accessed 26 September 2018.
141 Newgate Research, *Consumer Research for the Australian Energy Market Commission's 2017 Retail Competition Review*, April 2017, p 40.
142 Ibid, p 6.
143 G. Moss, Individual submission to IPART Information Paper, June 2018, p 1.

In August 2018, the changes to the Retail Pricing Information Guidelines (RPIG) commenced,[144] which should help customers compare discounted offers. These guidelines set out the requirements for how retailers must present their offers to customers. As part of the change, retailers' 'Basic plan document' will include an annual bill comparison table for different consumption levels so that customers can compare between offers without having to make any calculations.[145] This will ensure a customer is provided with consistent and clear information.

One submission considered that it would be very beneficial if a comparison chart could be published by an independent organisation to compare energy costs for different providers.[146] The AER, does this through its independent Energy Made Easy website, based on the consumption profile of the user. It makes it possible to compare a large number of offers for a customer's individual circumstances. The Energy Made Easy website calculates annual bills on a consistent basis based on customers' actual historical usage, or their household characteristics and ranks them by price.

The AER made major upgrades to Energy Made Easy in September 2018 to make the site more user friendly,[147] including making it easier to compare fees for different offers, and providing the functionality for customers to compare single-rate offers to time-of-use offers. However, last year, the AEMC found that last year, only 13% of customers in NSW were aware of Energy Made Easy.[148]

This year the AEMC also found that fewer customer are reporting that they can find the right information to help them compare offers. It found that:

- 49% of NSW residential customers reported that they were confident accessing easily understood information in April 2018, compared to 62% April 2017,[149] and
- 79% of business customers (NEM-wide) reported that they are confident in finding the right information in 2018, down from 89% in 2017.[150]

The ACCC's retail electricity pricing inquiry has recommended that the Government should commit to ongoing funding to raise awareness of the government-run comparator websites.[151]

While Energy Made Easy is a very good tool for customers to compare 'standard' offers, it does not yet have the functionality to assess the more innovative offers in the market. For example, for the 10% of NSW customers with solar panels[152], Energy Made Easy does not

144 AER, *Retail Pricing Information Guidelines 2018*, https://www.aer.gov.au/retail-markets/retail-guidelines-reviews/retail-pricing-information-guidelines-2018, accessed 26 September 2018.
145 AEMC, *2018 Retail energy competition review*, Final report, June 2018, pp 108-109.
146 D. Davidson, Individual submission to IPART Information Paper, May 2018, p 1.
147 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 102.
148 Newgate Research, *Consumer Research for the Australian Energy Market Commission's 2017 Retail Competition Review*, April 2017, p 107.
149 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 90.
150 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 120.
151 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 286.
152 IPART, *Solar feed-in tariffs*, The value of electricity from small-scale solar panels in 2018-19, June 2018, p 1.

factor in the feed-in tariff revenue that a household is likely to receive. It is also unable to compare offers for business customers with demand charges.[153]

We note that IPART provides a tool on its website to help compare offers after the solar feed-in tariff is factored into the bill calculation, based on how much solar energy they are likely to consume and export.

There are also a large number of privately run comparator websites that can also help customers compare and switch offers.

These commercial sites typically only include offers from a subset of retailers, and so the lowest offers in the market may not appear on these sites. The AEMC and the ACCC have recently made recommendations to ensure that these websites deliver outcomes that are in the best interests of customers.[154]

153 Demand charges (measured in kilowatts, kW) measure of how intensely electricity is used at a point in time, instead of usage over time. Energy Made Easy, *Which type of tariff is right for you?* https://www.energymadeeasy.gov.au/get-energy-smart/about-energy-offers/which-type-tariff-right-you, 27 September 2018.

154 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 84; ACCC, *Restoring electricity affordability & Australia's competitive advantage,* June 2018, p 282.

6 Electricity prices broadly reflect the cost of supply

As Chapter 2 discussed, for this review we extended our assessment of whether the movements in electricity and gas retail prices in 2017-18 are consistent with a competitive retail market to include to the most recent changes at the start of 2018-19.

In a competitive market, we would expect that prices broadly reflect the underlying market costs of supplying electricity. Therefore, we analysed the changes in the costs of supply electricity to identify the key drivers of the changes in retail prices.

The sections below provide an overview of our draft findings, and then discuss them in more detail. The following Chapter provides our analysis of the changes in gas prices and costs.

6.1 Overview of draft findings

Electricity prices remained relatively flat into 2018-19 in all three electricity network areas. We estimate that the average retail electricity prices for residential and small business customers increased by 0.2% in the period from 2017-18 and 2018-19 (ie, in 2017-18 and the start of 2018-19).[155] Many retailers held their electricity prices constant in July 2018, and other retailers increased them only slightly.

To assess price changes from 2017-18 to 2018-19, we obtained price data from Energy Made Easy in June 2018 and July 2018 and also requested information on retailers' prices for residential and small business customers in each network area in NSW, and calculated a weighted average bill for each period (Box 6.1).[156]

While electricity prices remained stable, we estimate that costs have decreased by around 9% for 2018-19.[157] This is mainly due to substantial reductions in forward wholesale prices of around 35%[158] (when we look at the average forward prices in June 2017, compared to June 2018).

Although retail prices did not decrease in line with the overall decrease in costs, we estimate that average prices have remained in line with **total costs** for 2018-19. This is because retailers did not increase prices in line with overall increase in costs in 2017-18, and so retailers have smoothed the impact of wholesale cost changes on bills over a period longer than a single year.

155 In general, retailers can change their prices at any time subject to their contractual obligations. They can also make new offers and withdraw offers from the market at any time. However, typically retailers change prices in July of each year, when the regulated network prices change.

156 Retailers update their offers throughout the year and so June prices are not necessarily reflective of prices across the 2017-18 financial year.

157 ACIL Allen, *Cost drivers of recent retail electricity and gas prices for small customers in NSW*, September 2018, p iii.

158 *Ibid*, p 12.

Box 6.1 How we estimated the average bill across NSW

We obtained price data from Energy Made Easy to estimate bills for the lowest and standing offers for all retailers. Retailers have also provided us with their prices for their most common offers, and the number of customers on these offers. However, we do not have information on the number of customers on every offer type. Therefore, when estimating the average residential bill paid by NSW customers, we have had to make a number of assumptions about the number of people paying different prices.

We estimated the average bill for the typical residential consumer by weighting prices by the number of customers on standing and market offers, by retailer, and by the number of customers in each network area, for each year.

For each network area:

1. For customers on standing offers we use the standing offer prices for each retailer's market share (applying the NSW-wide retail market share to each network area) to estimate annual bills.
2. For customers on market offers, we weighted prices by retailers' market shares and we allocated customers to either retailers' lowest offer, their most common offer, expired offers on standing offer prices, or an offer between the lowest offer and the standing offer as follows:
   - 10% are allocated to retailers' lowest offer (and applying the full value of any unconditional and conditional discounts)
   - 30% are allocated to the most common offer (and applying the full value of any unconditional and conditional discounts)
   - 35% are allocated to standing offer prices, to reflect customers on standing offers, and customers on market offers where the discount has expired.[a]
   - The remaining customers are allocated to a price equal to the mid-point between the lowest and standing offer prices. This is to account for the range of other offers in the market between the lowest offer and the standing offer.

To estimate the average residential bills across NSW, we then weighted the average price for each network area by the proportion of customers in each network area (42% in Ausgrid, 26% in Essential, and 31% in the Endeavour network area).

We consider that these assumptions provide a reasonable estimate of the average residential bill paid across NSW. We tested a range of different assumptions and they led to very similar estimates of average bills. However, we are seeking feedback on this methodology for our Final Report.

a AEMC, *2018 Retail Competition Review,* June 2018, p 62.

6.2 The costs of supplying electricity are lower in 2018-19

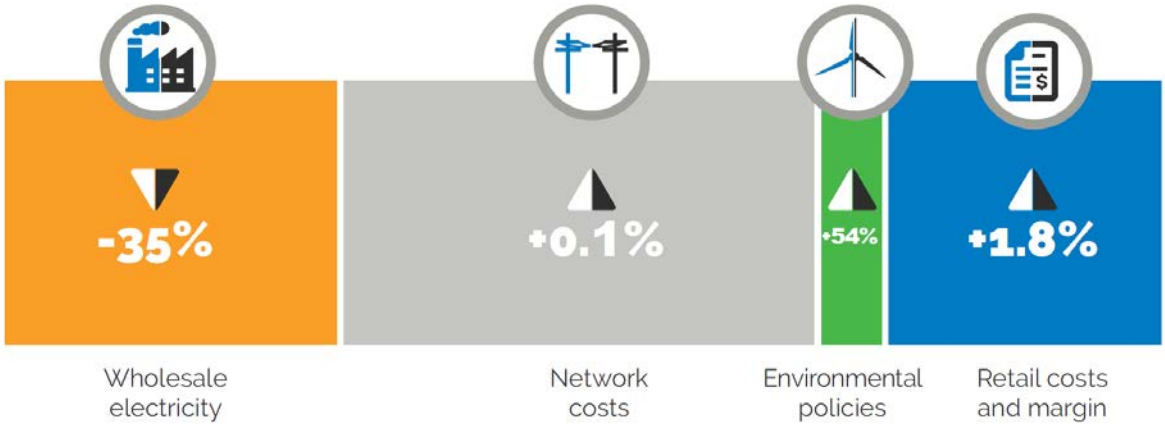
We engaged economic consultants ACIL Allen to examine the cost drivers behind the increases in retail electricity prices for 2018-19, and to estimate the overall price changes for an efficient retailer. If the price changes broadly reflect the changes in the underlying costs of supply, then we would consider that they are consistent with a competitive retail market.

We found that the overall costs of supply have fallen by between around 8% and 11% using a point in time approach (depending on the customer type and approach).[159] Figure 6.1 summarises our draft findings on changes in each cost component (See Box 6.2), and the next sections explain the changes in each cost component in detail.

The methodology used by ACIL Allen is the same as we have used in previous years, and is explained in its report, which is available on our website.

The Australian Energy Council submitted that IPART should use the ACCC's Electricity Supply Inquiry data and the AEMC's Retail Competition data when assessing price changes to avoid unnecessarily duplication.[160] We have engaged ACIL Allen to analyse the cost drivers of the recent 2018-19 price changes because these other reviews only examined price changes up until the end of 2017-18.

Figure 6.1 Change in residential electricity costs in 2018-19



Note: The range for the wholesale cost changes is very large because it includes estimates from three different estimation methods. For more information, see page ii of ACIL Allen's report.

Data source: ACIL Allen, *Cost drivers of recent retail electricity and gas prices for small customers in NSW,* September 2018, piii, p12.

159 ACIL Allen, *Cost drivers of recent retail electricity and gas prices for small customers in NSW,* September 2018, p iii.

160 Australian Energy Council submission to IPART Information Paper, August 2018, p 2.

Box 6.2 Customers' bills are made up of a number of different cost components

Customers' bills are made up of different cost components:

- Costs incurred by retailers in purchasing wholesale electricity through the NEM.
- The network costs, which are the regulated costs of transporting electricity from the generators to customers via the transmission and distribution networks, and are set by the AER.
- The cost of meeting 'green scheme' obligations including the:
  - Commonwealth Renewable Energy Target (RET), which requires retailers to purchase:
    - 33,000 gigawatts of additional renewable electricity from renewable energy power stations, such as wind and solar farms, or hydro-electric power stations, under the (Large-scale Renewable Energy Target (LRET)), and
    - Small-scale technology certificates created under the Small-scale Renewable Energy Scheme (SRES)) created by small scale systems, including solar photovoltaic (PV) panels and other small generation systems.
  - NSW Energy Savings Scheme (ESS), which requires retailers to purchase and surrender a certain number of Energy Savings Certificates (ESCs) representing energy savings.
- Retail costs and margin which retailers incur in performing their retail functions. These costs include customer service (eg, operating call centres), billing and collecting revenue, finance, IT systems, regulatory compliance costs, energy trading costs, marketing costs and an appropriate allocation of corporate overheads. Retailers face a range of risks in supplying electricity, including variations in customer demand and economic conditions, and the retail margins also reflect these risks.

Source: Clean Energy Regulator, How the scheme works in *Renewable Energy Target,* 31 May 2018, http://www.cleanenergyregulator.gov.au/RET/About-the-Renewable-Energy-Target/How-the-scheme-works, accessed 21 September 2018, IPART, How the scheme works in *Energy Savings Scheme, https://www.ess.nsw.gov.au/How_the_scheme_works*, accessed 21 September 2018.

6.2.1 Wholesale prices have decreased substantially using a point-in-time approach

The two key drivers of changes in wholesale energy costs are:

- **Changes in load shape**: The load shape for customers is a key determinant of the cost of supplying electricity. Broadly speaking, the "peakier" the load shape, the more expensive it is to supply electricity to customers. Considering data on the net system load profile for NSW over the last 10 years, we found that there is no strong evidence that suggests higher wholesale energy costs are driven by changes in load shape.
- **Changes in spot and contract electricity prices:** We use the forward contract prices on the ASX for a mix of contracts types (baseload, swaps, caps) to compare wholesale electricity prices in June 2017, compared to June 2018 for different periods:
  - **a)** as at 1 June 2017,
  - **b)** for the 30 day average to June in each year, and
  - **c)** the two-year average to June each year.

Using a 'point in time' approach (ie (a) and (b) above), we found that the wholesale energy costs decreased between 34% and 38%.[161] We prefer to measure changes in costs using a 'point-in-time' approach, because the new entry or the threat of new entry would constrain prices to current market levels. To the extent that retailers' historical costs are higher than market levels, they would not be able to pass these through to retail prices.

The fall in wholesale costs for 2018-19 reflects increased supply, as the Swanbank E gas power station was returned to service, and a number of renewable generation projects have recently come online.[162]

These decreasing costs follow a substantial increase in wholesale costs in 2017-18 due to the retirement of a number of generators, including Munmorah, Wallerawang C, Redbank and Smithfield and Hazelwood. Since NSW is connected to the NEM, the closure of Hazelwood in particular (a coal fired power station in Victoria), had a substantial impact on the volatility of wholesale prices in NSW. The retirement of coal-fired power stations has meant that higher marginal cost generation plants – in particular gas fired plants – have been setting the market clearing price more often. This is at the same time as gas prices have increased due to a tightening of supply and demand conditions.

Because of the volatility in wholesale prices, the change in estimated wholesale costs varies substantially when different averaging periods are used to measure the change in forward wholesale costs (Table 6.1). When the change is measured using the average forward wholesale price over a two year period (ie method (c) above), costs have increased by 10.6% for residential customers and 13.7% for business customers, compared to the large cost reductions under the other two methods.

Table 6.1 Comparison of retail price changes and weighted average cost changes 2018-19

Customer type	Change in costs		
	One day	One month averaging period	Two year averaging period)
Change in wholesale cost			
All customers	-34% to -38%	-34% to -38%	22%
Change in total costs			
Residential customer	-7.5%	-8.8%	10.6%
Small business customer	-9.3	-11.0%	13.7%

Source: ACIL Allen, *Cost drivers of recent retail electricity and gas prices for small customers in NSW,* September 2018, p iii, p 12.

6.2.2 Green scheme costs have increased by around 50%

To estimate the costs of complying with green schemes, we used a similar approach to that used to estimate changes in wholesale electricity costs. However, since there are no reliable forward prices for green schemes, we used actual spot prices of large scale generation

161 ACIL Allen, *Cost drivers of recent retail electricity and gas prices for small customers in NSW*, September 2018, p 13.
162 *Ibid*, p 12.

certificates (LGCs) and small-scale technology certificates (STCs) as a proxy for expected certificate prices.

The estimated change to green scheme costs is 54%.[163] We estimate that the change in the cost of complying with the Small-scale Renewable Energy Scheme (SRES) is 140%, which is fairly consistent across the three averaging periods used to estimate costs. Similarly, the cost of complying with the Large-scale Renewable Energy Target (LRET) increased across all estimation methods. The costs of the LRET scheme increased by between 12% and 20%.[164]

Large retailers typically obtain the majority of their LGCs through long term agreements such as power purchasing agreements with wind generators. However, some businesses facing a shortage of LGCs may be acquiring LGCs through the spot market, placing upward pressure on LGC spot prices.[165]

ACIL did not find any evidence that there was a material change to the costs of ESS.[166]

6.2.3 Network costs have increased by an average of 0.1%

Retailers incur network costs to supply electricity to retail customers. These costs include payments for the use of the transmission and distribution network, which are passed through to customers. We estimate that for 2018-19, network costs make up around 40% of the average customer's total bill.[167]

Across the three network areas in 2018-19, network costs for a typical residential customer increased by 0.1%, and network costs for a typical small business customer increased by 0.65%.[168] This varied slightly across network areas. Network costs decreased by around 0.5% in the Ausgrid network, and were relatively unchanged in the Endeavour network. In the Essential region, network costs increased by 2.4%.

6.2.4 Retail costs are relatively unchanged

There is no strong evidence to suggest that retail costs changed substantially in 2018-19. ACIL Allen estimated that retail costs increased in line with inflation, and applied an index of 1.81%[169]

163 ACIL Allen, *Cost drivers of recent retail electricity and gas prices for small customers in NSW* – September 2018, p 17.
164 Ibid, p 18. Based on the 2017-18 and 2018-19 network prices published by Ausgrid, Endeavour Energy and Essential Energy.
165 *Ibid*, p 15.
166 *Ibid,* p 17.
167 *Ibid*, p 5
168 *Ibid*, p 19.
169 *Ibid*, p 23.

6.3 Prices are likely to reflect the underlying changes in supply

Our draft findings indicate that prices did not fall in line with the changes in costs for 2018-19.[170] We therefore considered if prices are likely to be exceeding the level of costs of supply as a result.

We consider that average prices currently reflect the level of underlying costs, and that retailers have smoothed the impact of wholesale cost changes on bills over a period longer than a single year. This is because retailers did not increase prices in line with overall increase in costs in 2017-18. In 2017-18, wholesale electricity costs were expected to increase by around 140% (from around $50/MWh to around $115/MWh).[171] If retailers had passed the full extent of this increase through to retail prices in 2017-18, these prices would have increased by around 30%.[172] However, we found that prices only increased by around 15% last year.

When we considered the cumulative changes in wholesale costs across 2017-18 and 2018-19, we found that they increased by around 50%.[173] Over these two years, this likely added around 12% to the average costs of supply.[174] This is very similar to the cumulative increase in average bills of 12% to 16% over the two years, depending on the network area (noting there have also been changes in other cost components). As a result, we do not consider that prices are exceeding the costs of supply.

6.3.1 A detailed review of profit margins is not necessary

As part of our role as the Market Monitor, we are required to report on whether a detailed review of retail prices and profit margins in the market is required.[175]

As explained in the section above, we do not consider that there is evidence that prices are higher than the underlying costs of supply. Therefore we do not think a detailed review is necessary.

In addition, we consider that another review would duplicate the recent work completed on electricity retail prices by the ACCC. As part of the ACCC's inquiry, it reviewed the change in retail costs over the last ten years. It found that for 2017-18, the retail cost component made up around 18% of total costs, comprising retail costs of $129, and average retail margins of $170, with EBIT margins averaging 8% over the last three years. It found that retail margins of the big three are substantially higher than the smaller retailers.

170 *Ibid*, p 25.
171 Data from Thomson Reuters Eikon. Frontier Economics, *Cost drivers of recent retail electricity and gas prices for residential customers in NSW- A report prepared for IPART*, September 2017, p 17.
172 Frontier Economics, *Cost drivers of recent retail electricity and gas prices for residential customers in NSW*, October 2017, p 36.
173 From around $50/MWh to around $75/MWh. Data from Thomson Reuters Eikon.
174 IPART calculations, based on Frontier Economics, Cost drivers of recent retail electricity and gas prices for residential customers in NSW, October 2017, pp 10, 36 Table 2, approach 2; ACIL Allen, *Cost drivers of recent retail electricity and gas prices for small customers in NSW*, September 2018, piii, p 12.
175 Section 234A(3) (g) of the *National Energy Retail Law (NSW).*

Draft Findings

4 The average electricity bill for residential and small business customers increased by 0.2% in the period from June 2018 to July 2018. However, costs have decreased by around 9% for 2018-19. This is mainly due to substantial reductions in forward wholesale prices of around 35% in 2017-18 (average forward prices in June 2017, compared to June 2018).

5 Although electricity retail prices did not decrease in line with the overall decrease in costs in 2018-19, average prices have remained in line with the underlying total costs. This is because retailers increased prices by less than the change in costs last year.

6 A detailed review of electricity retail prices and margins is not necessary as the ACCC has recently completed its Retail Electricity Pricing Inquiry.

7 Gas prices are becoming more efficient

We also analysed the changes in the costs of supplying gas to identify the key drivers of the changes in retail gas prices. As explained in Chapter 6, in a competitive market, we would expect that prices broadly reflect the underlying market costs of supply.

The sections below provide an overview of our draft findings, and then discuss them in more detail.

7.1 Overview of draft findings

Our draft finding is that the average gas bill in July 2018 for residential coastal customers in the Jemena network was relatively unchanged compared to June 2018, increasing by 0.2%. For coastal business customers, the average bill increased by 1.6%. In country areas, the average gas bill for country residential and small business customers decreased by around 2%.

While the average bills have been flat or have fallen, the costs of supplying gas (excluding retail costs) have increased by between 2% and 6% in 2018-19.[176] These have been driven by a 13% increase in wholesale costs due to tight supply-demand conditions in eastern Australia.[177] Because bills have remained relatively constant while underlying costs have increased, retail margins are likely to be lower this year.

We found that coastal residential and small business prices are reflective of efficient costs, and are therefore consistent with a competitive market. Our draft finding is that the retail cost component in country areas is substantially higher than in coastal regions. However, the retail component has fallen this year, suggesting that competition is increasing in these areas and putting downward pressure on prices.

7.2 Coastal prices were relatively unchanged from June 2018 to July 2018

For customers located in the Jemena network (coastal customers), we estimated the change in prices by estimating a weighted average bill for June 2018, and comparing it with July 2018.[178] We found that retail gas prices increased by 0.2% for residential customers and increased by 1.6% for small business customers between June 2018 and July 2018.

176 Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW- prepared for: IPART*, September 2018, pp 33-41.

177 *Ibid*, p 23.

178 We calculated weighted average annual bills based on prices advertised on Energy Made Easy, information from retailers on their prices for their most common energy offers.

Table 7.1 Average gas coastal retail bills (GST-inclusive, nominal)

	June 2018	July 2018	% change
Residential coastal NSW	$859	$861	0.2%
Small business coastal NSW	$5,218	$5,301	1.6%

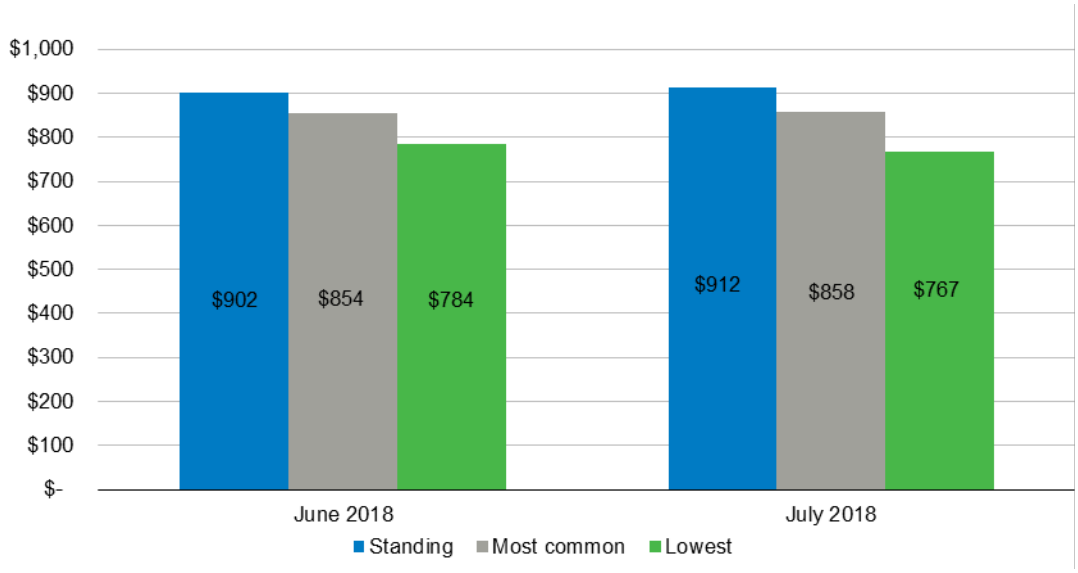
Note: Coastal NSW refers to the Jemena distribution area. We used annual consumption of 20 GJ for residential coastal customers and 184 GJ for small business customers. Weighted average annual bills are calculated as explained in Box 3.2. Retailers' market shares for coastal customers are from the AER's retail statistics and those for country customers are from IPART's household survey results for the Riverina area.

Source: IPART calculations based on Energy Made Easy data and price information provided by retailers.

As explained in Chapter 4, prices vary depending on whether they are standing offer or market offer prices. For standing offers, the average increase in residential customers' bills between June 2018 and July 2018 was around 1%. The most common offers were relatively unchanged, and the lowest offers decreased by around 2% (Figure 7.1).

For small business customers, the most common offer increased by around 1%, while the standing and the lowest offers increased by around 2%.

Figure 7.1 Estimated annual gas bills for typical residential customers by offer type coastal NSW (GST-inclusive, nominal)



Note: Bills are calculated based on annual consumption of 20 GJ, taking into account all available conditional and non-conditional discounts.

Data source: IPART calculations based on Energy Made Easy accessed on 1 June 2018 and 31 July 2018 and pricing information submitted by retailers.

7.3 Country prices decreased from June 2018 to July 2018

As discussed in Chapter 3, the country region includes ten different distribution networks.

On average across these networks, we found that the average bill fell by 2.1% for residential customers and 1.6% for small business customers between June 2018 and July 2018 (Table 7.2).[179]

Table 7.2 Average gas country retail bills (GST-inclusive)

	June 2018	July 2018	% change
Residential country NSW	$1,287	$1,260	-2.1%
Small business country NSW	$6,090	$5,995	-1.6%

Note: We used annual consumption of 41 GJ for residential customers. We used a range of consumption levels for small business customers, depending on the distribution area. The small business country consumption levels vary from 209GJ for the AGN Albury distribution area, to 346 GJ in the AGN Murray Valley distribution area. Weighted average annual bills are calculated as explained in Box 3.2. Retailers' market shares for coastal customers are from the AER's retail statistics and those for Country customers are from IPART's household survey results for the Riverina area.

Source: IPART calculations based on Energy Made Easy accessed on 1June 2018 and 31 July 2018 and pricing information submitted by retailers.

As for coastal customers, the change in bills also depended on the offer type. Across all the country regions, we found that standing offers and lowest offers for residential customers fell by an average of 2% and 4.2% respectively, and the most common offer fell by around 1% from June 2018 to July 2018 (Figure 7.2).

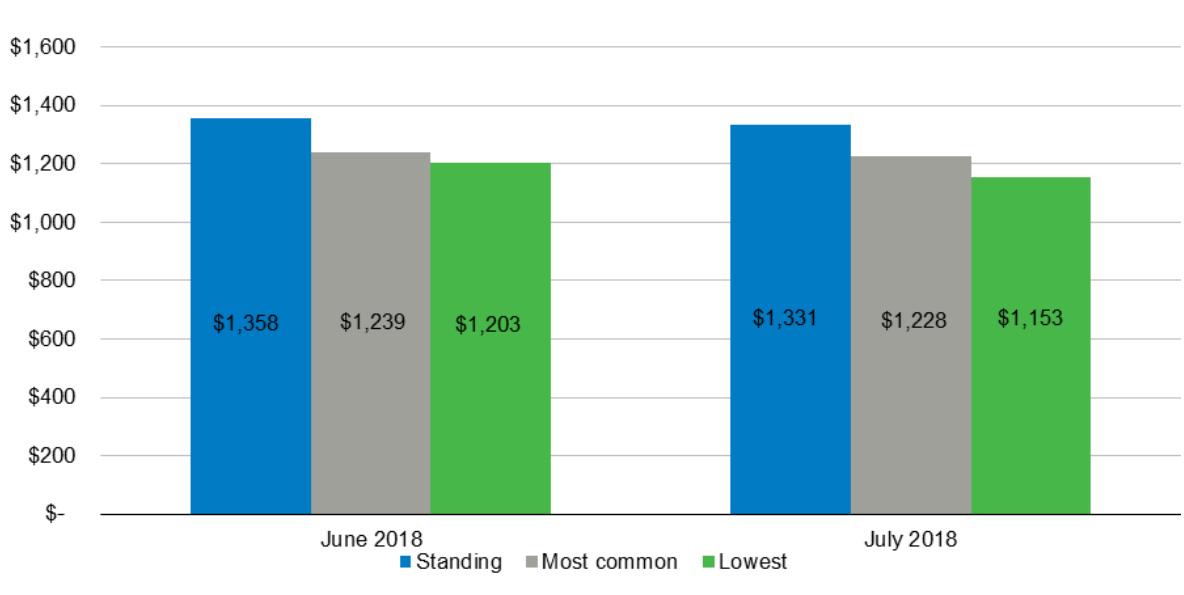
Of note, both the standing and lowest offers in the AGN Adelong, Gundagai and Tumut distribution zones decreased by around 14% in July 2018. This translates to a reduction of around $203 to $229 on the average annual bill for residential customers. By contrast, in the Evoenergy Queanbeyan and Evoenergy Shoalhaven regions standing offers increased by around 6%.[180]

For small business customers in country areas, the standing, most common and lowest offers decreased by between 1% and 3% from June 2018 to July 2018.

179 Bills for small business country customers are estimated using a range of annual consumption levels between 209 GJ and 346 GJ, depending on the distribution area.

180 As of January 1 2018, the ActewAGL network changed its name to Evoenergy.

Figure 7.2 Estimated annual gas bills for typical residential customers by offer type in country NSW (GST-inclusive)



Note: Country refers to all NSW distribution zones, excluding Jemena. Bills are calculated based on annual consumption of 41 GJ, taking into account all available conditional and non-conditional discounts. All country distribution areas were weighted equally.

Data source: IPART calculations based on Energy Made Easy accessed on 1 June 2018 and 31 July 2018 and pricing information submitted by retailers.

7.3.1 There is variation in the prices available to customer across country networks

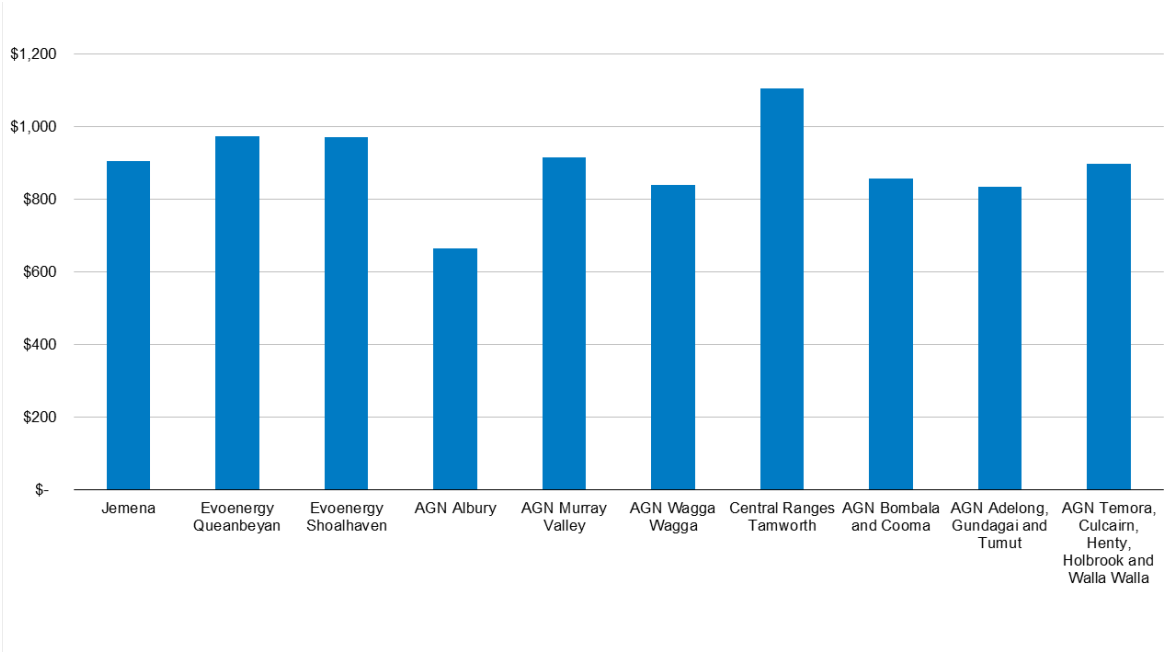
The estimated annual bills for country customers in Table 7.2 are higher than those for coastal customers due to the higher average annual consumption in country NSW. The higher consumption levels are due to greater demand for gas for space heating in country zones with cooler climates.[181]

Figure 7.3 compares standing offer prices for each distribution zone using the same underlying consumption level for each. It shows that there is a substantial variation in prices, depending on the distribution zone.[182] The highest standing offers are in the Central Ranges Tamworth distribution zone. The gas network was only recently expanded to Tamworth, and only Origin Energy is supplying customers in this region. The lowest average standing offers are in the AGN Albury distribution zone, which has lower transmission costs because it is close to the Victorian gas network.

181 We have used the AER's 2017 bill benchmarks (rounded to the nearest GJ) to estimate average residential gas consumption. For country customers in the AGN distribution zones, 41GJ is the average annual residential consumption level.

182 There are ten different distribution zones in country areas.

Figure 7.3 Bill estimates for average standing offers with 20 GJ consumption (GST-inclusive)



Note: We have compared the average standing offer in each NSW gas distribution zone with 20 GJ consumption. We have not included the Allgas network in our analysis, which typically services the Tweed Heads region.

Data source: Energy Made Easy.

7.4 Changes in the underlying costs of supplying gas from July 2018

Retailers incur a number of different costs to supply gas, including:

- **wholesale gas costs**, which are the costs that retailers face in procuring the gas that they supply to their customers,
- **network costs**, which include payments for the use of the transmission pipelines and the distribution network, and
- **retail costs and margin**, which include the costs that a retailer incurs in operating its retail business to supply gas to its customers (ie, retail operating costs), and the return that it requires to attract the capital needed to provide a retailing service (ie, retail margin).

We engaged Oakley Greenwood to examine the changes in these costs for 2018-19 and to estimate reasonable overall price changes from 2017-18 to 2018-19 for an efficient retailer.

We found that the total costs of supplying gas (excluding retail costs) increased by around 2% for coastal customers and by between 3% and 6% for country customers.[183] This was primarily due to an increase in wholesale gas costs (see Figure 7.4 and Figure 7.5). As wholesale gas costs represent a bigger proportion in the total bill for country customers, the increase in wholesale gas costs has a bigger impact on country customers than on coastal customers.

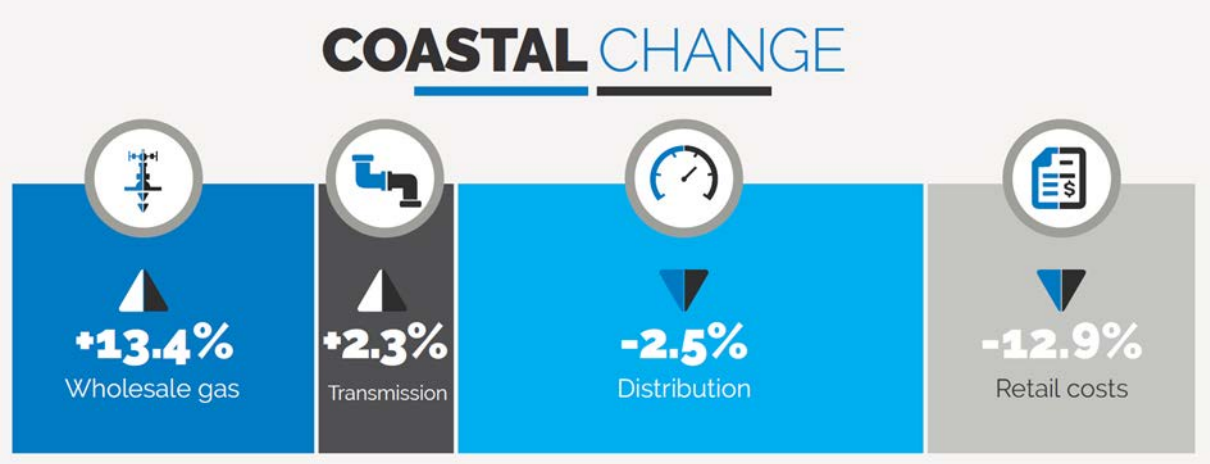
183 Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW- prepared for: IPART*, September 2018, p33- p41.

Oakley Greenwood has estimated the change in the retail component as the residual after subtracting the other costs from the total bill. Because the other costs have increased while the total bill has remained relatively flat, the retail component has fallen.

We found that in the coastal gas market for both residential and small business customers, there are market offers that reflect the efficient costs of supply. In country areas, retail costs are higher than in coastal areas.[184] Oakley Greenwood found that in some areas, they are likely to be exceeding the costs of supply.[185] As discussed in Chapter 3 the limited number of retailers operating and the fewer number of customers in country areas means that competition is not likely to be as strong as in coastal areas. However, the decrease in both the average country bill and the retail cost component in 2018-19 suggests that competition is developing and putting downward pressure on prices and margins.

Oakley Greenwood's full report is available on our website www.ipart.nsw.gov.au.

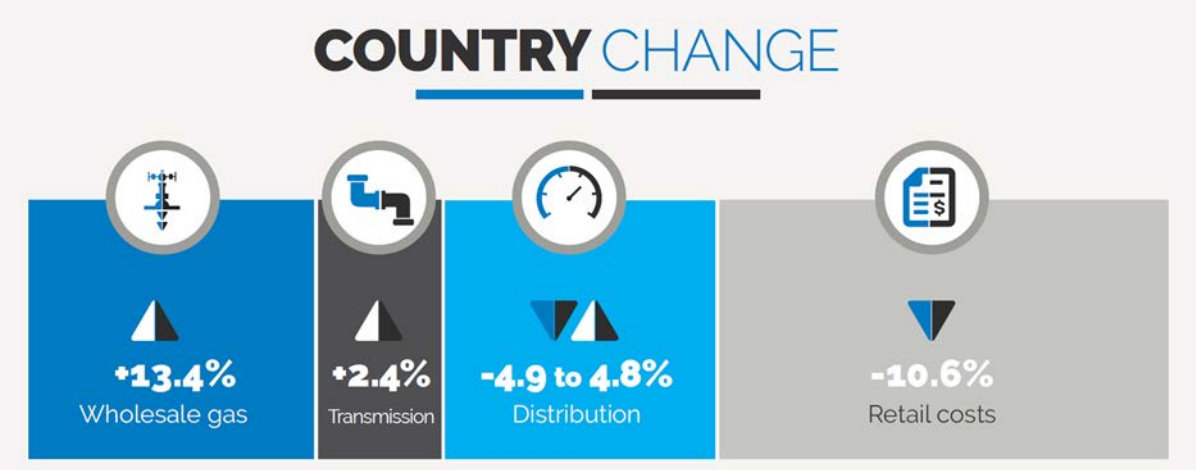
Figure 7.4 Changes in cost components of supplying gas to residential coastal customers



Data source: Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW*, September 2018.

184 *Ibid*, p 9.
185 *Ibid*, pp 49-53.

Figure 7.5 Changes in cost components of supplying gas to country customers



Data source: Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW*, September 2018.

7.4.1 Wholesale gas costs have increased

Origin submitted that its recent 3% reduction in prices has been driven by falling wholesale gas costs. It noted that the ACCC's gas monitoring reports found that gas prices peaked in early 2017.[186]

However, we found that wholesale costs in NSW have increased by 13.4% from 2017-18 to 2018-19.[187] This is consistent with the forward looking estimate for gas prices in the ACCC's Gas Inquiry Interim Report, which indicates a forward looking increase from an average of $8.68/GJ to $9.40/GJ.[188]

A tightening of the demand and supply balance in eastern Australia is the main contributor to these wholesale cost increases. This follows substantial wholesale cost increases ranging from 55% to 85% in our previous review.[189]

7.4.2 Network costs

Network costs, which include the transmission and distribution costs, account for around 50% and around 33% of the total gas supply costs for residential coastal and country areas, respectively. Distribution costs have decreased by around 2.5% for coastal customers. For country customers, distribution costs have decreased in some areas by up to -4.9%, and increased in other areas by 4.8%. Transmission costs increased by around 2.5% for all customers.[190]

186 Origin submission to IPART Information Paper, August 2018, p 2.
187 Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW- prepared for: IPART*, September 2018, p 7.
188 *Ibid*, p 7.
189 Frontier Economics, *Cost drivers of recent retail electricity and gas prices for residential customers in NSW – A report prepared for IPART,* November 2017, p 47.
190 Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW*, p 29.

7.4.3 Retail costs

Retail costs, which include retail operating costs and retail margins, account for 23% and 37% of the total gas supply costs for residential coastal and country areas, respectively. Retail costs represent a bigger proportion in the total costs for gas retailers than for electricity retailers. In part this is because retail operating costs represent the same fixed amount for both electricity and gas, though gas bills (for coastal areas) tend to be smaller than electricity bills.

Oakley Greenwood imputed gross retail costs (i.e., the sum of retail operating costs and net margin) from the prices that are available in the market. As bills remained stable in 2018-19, while other costs increased by between 2% and 6%, this implies that the retail component has fallen in both the coastal and country distribution areas in 2018-19.

The fall in the retail component is likely to reflect lower retail margins this year (rather than falling retail costs). This is consistent with retailers' annual reports, which state that the cost of serving, acquiring and retaining customers has increased. They noted factors such as greater call volumes and higher costs of advertising, which have contributed to higher retail costs. The retailers have also reported that higher total costs in 2018-19 have led to a decrease in retail margins.[191]

7.4.4 A detailed review of profit margins is not necessary

As part of our role as the Market Monitor, we are required to report on whether a detailed review of retail prices and profit margins in the market is required.[192]

In previous reviews, we have assessed whether prices reflect efficient costs by comparing the relationship between price changes and cost changes. However, for this review Oakley Greenwood undertook a comprehensive analysis of the underlying costs of supply for residential and small business gas customers in both coastal and country NSW. In doing so, it considered all major cost components of the bill, including retail margins, and found that prices broadly reflect efficient costs.

As a result, we do not consider that there is evidence that prices are higher than the underlying costs of supply. Therefore we do not think a detailed review is necessary.

Further, an additional review would duplicate the current work being undertaken by the ACCC. The ACCC has been directed to conduct a wide ranging inquiry into the supply and demand for wholesale gas in Australia. The key focus of the inquiry is to report on the key factors influencing domestic gas prices, but it will be reporting on retailers' costs and margins throughout the course of the review.[193]

191 Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW*

192 Section 234A(3) (g) of the National Energy Retail Law (NSW).

193 ACCC, *July 2018 Gas Inquiry Interim Report- Media release*, *https://www.accc.gov.au/media-release/east-coast-gas-market-conditions-have-eased-but-more-gas-required-to-lower-prices*, accessed 26 September 2018.

Draft Findings

7 The average gas bill for residential coastal customers in the Jemena network (which covers 95% of NSW gas customers) increased by 0.2% for residential customer and increased by 1.6% for small business customers between June 2018 and July 2018. In country areas, the average gas bill for country residential and small business customers decreased by around 2%. However costs (excluding retail costs) have increased by between 2% and 6% in 2018-19 driven by a 13% increase in wholesale costs due to tight supply-demand conditions in eastern Australia.

8 It is not necessary for IPART to undertake a more detailed review of retail gas prices and margins as this work is currently being done by the ACCC.

8 Outcomes for electricity customers since price deregulation

While Chapters 6 and 7 considered the average price change between June 2018 and July 2018, this chapter considers how prices have changed over a longer period. We looked at electricity price movements for residential and small business customers since 2013-14, just before the retail electricity market in NSW was deregulated.

This chapter considers how prices have changed in each network area, and the prices for different offer types (ie, standing and market offers).

8.1 Overview of draft findings

Since electricity prices were deregulated in 2013-14, we found that electricity prices on average across NSW have fallen in real terms, after adjusting for inflation.[194] However, the price changes vary materially by network area.

Our draft finding is that average bills for metropolitan customers in the Ausgrid and Endeavour networks have increased by around 9% in nominal terms, which translates to a 1% reduction in prices in real terms. However, the average bill in the Essential network is substantially lower when compared to 2013-14. Bills for Essential customers have fallen by around 5% in nominal terms, which is a 13% reduction in real terms.

The large decrease in retail bills in the Essential network is due to larger reductions in network costs when compared to metropolitan areas. Network costs have also fallen in the Ausgrid and Endeavour networks, but these reductions have been more than offset by the large increases in wholesale costs in 2016-17 and 2017-18.

We also found that the spread of offers has increased since 2013-14 in all network areas. In 2013-14 the difference between the standing and the lowest offer was around 12% to 15%, which has now increased to a difference of around 19% in July 2018.

For small business customers, price changes since 2013-14 vary by network area. Bills for small business customers in the Essential network area have broadly decreased since 2013-14. However, the price changes since 2013-14 for small business customers in metropolitan regions vary substantially depending on the type of offer.

[194] The weighted average bill for NSW (across all network areas) has fallen by 4.7% in real terms.

8.2 Average bills for metropolitan customers are similar to 2013-14 in real terms

Table 8.1 shows residential customers' bills by network area. The Ausgrid and Endeavour networks supply metropolitan customers in Sydney and Newcastle (Ausgrid), and South-western Sydney and Wollongong (Endeavour). The Essential network supplies regional customers in the remainder of the state.

For a customer in the Ausgrid and Endeavour regions using 5,100 kWh per year, the average bill in 2018-19 is around $1,750, up from around $1,600 in 2013-14 before prices were deregulated. This is an increase of around 9%, or a fall in real terms of around 1%.

In the Essential network area, the average bill is $2,038, down from $2,134 in 2013-14. This represents a price reduction of 4.5% since prices were deregulated, which is a 13.1% fall in prices in real terms.

While bills in regional areas are still higher than in the metropolitan regions, the difference between them has reduced over time. In 2018-19, the average residential bill in regional areas is around 16% higher than in metropolitan areas, compared to 32% higher in 2013-14.

Table 8.1 Average household bills by network area (weighted by offer type, 5,100 kWh pa, nominal, GST-inclusive)

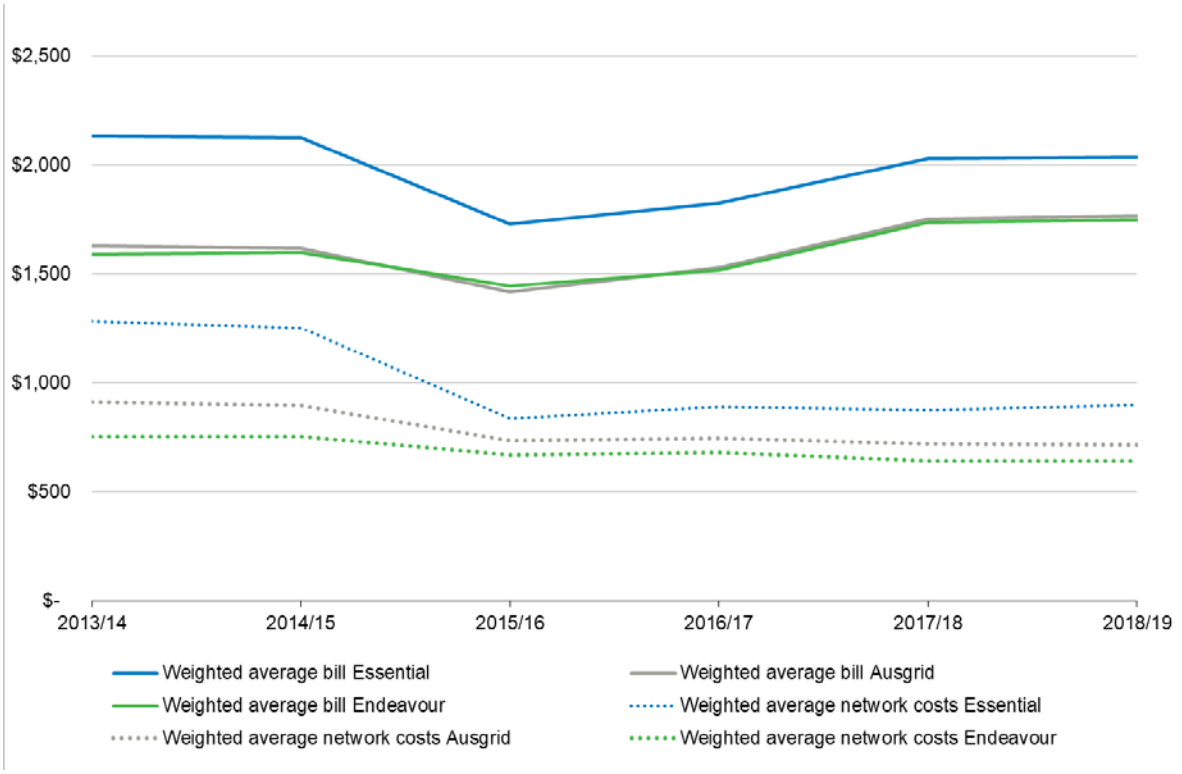
	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	Cumulative change	
Ausgrid	$1,628	$1,617	$1,417	$1,528	$1,751	$1,766	$138	8.5%
Endeavour	$1,592	$1,598	$1,445	$1,515	$1,738	$1,747	$155	9.7%
Essential	$2,134	$2,126	$1730	$1825	$2,030	$2,038	-$97	-4.5%
Weighted average typical bill	$1,750	$1,745	$1,508	$1,602	$1,820	$1,832	$81	4.7%

Source: Energy Made Easy and information provided by retailers

8.2.1 Bill decreases in the Essential region are due to large reductions in network costs

Figure 8.1 shows the annual bills for a typical residential customer in each network, along with the costs of the network services since 2013-14. It shows the costs of providing network services in the Essential region are around 31% higher than the metropolitan regions (down from 50% higher in 2013-14).

Figure 8.1 Change in the network costs compared to average household bill for residential customers by network area (5,100 kWh pa, nominal, GST-inclusive)



Data source: Information from retailers, Energy Made Easy network price data.

The difference between bills in regional and metropolitan areas has narrowed since 2013-14. This is because there have been larger network cost reductions in the Essential network, compared to Ausgrid and Endeavour. On 1 July 2015[195], network prices for residential customers fell by 11% (Endeavour), 18% (Ausgrid) and 33% (Essential). Across the five year period, network prices have fallen by an average of 23% in nominal terms, or 30% in real terms (see Table 8.2).

Table 8.2 Average network charges by network area (5,100 kWh pa, nominal, GST-inclusive)

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	Cumulative change	
Ausgrid	$911	$895	$734	$745	$719	$715	-$195	-21.4%
Endeavour	$752	$755	$669	$680	$643	$642	-$110	-14.6%
Essential	$1,281	$1250	$837	$890	$875	$896	-$385	-30.1%
Weighted average	$958	$945	$741	$763	$736	$740	-$218	-22.8%

Source: Ausgrid, *Price Lists and Policy, https://www.ausgrid.com.au/-/media/Documents/Regulation/Pricing/PList/Ausgrid-Network-Price-List-FY-201819.pdf*, accessed 19 September 2019, Endeavour Energy, *Our prices, http://endeavourenergy.com.au/wps/wcm/connect/e00d5bac-8adb-4d57-a525-540e1c2baf31/NUOS+Price+List_201819_v3.0.pdf?MOD=AJPERES*, accessed 19 September 2018, Essential Energy, *Electricity Network Pricing, https://www.aer.gov.au/system/files/Att.6%20Essential%20Energy%20Annual%20Network%20Pricing%20Report%202018-19_0.pdf*, accessed 19 September 2018.

8.2.2 The weighted average bill across NSW has increased by around 5% since price deregulation

When we average the bills for each network area across NSW, we estimate that the average annual bill for NSW residential customers is $1,832. This is an increase of 4.7% or $81 since 2013-14, which represents a 4.7% or $91 reduction in prices in real terms (Table 8.3).

Table 8.3 Changes in residential customer bills over time (5,100 kWh, nominal, GST-inclusive, average across all distribution areas)

	July 2013	July 2014	July 2015	July 2016	July 2017	July 2018	Cumulative
Weighted average typical bill (nominal)	$1750	$1745	$1508	$1602	$1,820	$1832	$81
		-0.3%	-13.6%	6.2%	13.6%	0.6%	4.7%
Weighted average typical bill (real)	$1923	$1861	$1,585	$1,667	$1859	$1832	-$91
		-3.2%	-14.9%	5.2%	11.5%	-1.5%	-4.7%

Source: IPART calculations based on Energy Made Easy data and price information provided by retailers.

Draft Findings

9 The average electricity bill increase for residential customers in metropolitan areas since price deregulation is around 9%. This is a real decrease in prices of 0.8% (once CPI is accounted for).

10 The average electricity bill decrease for residential customers in regional areas since price deregulation is 4.5%. This is a real decrease in prices of 13.1% (once CPI is accounted for).

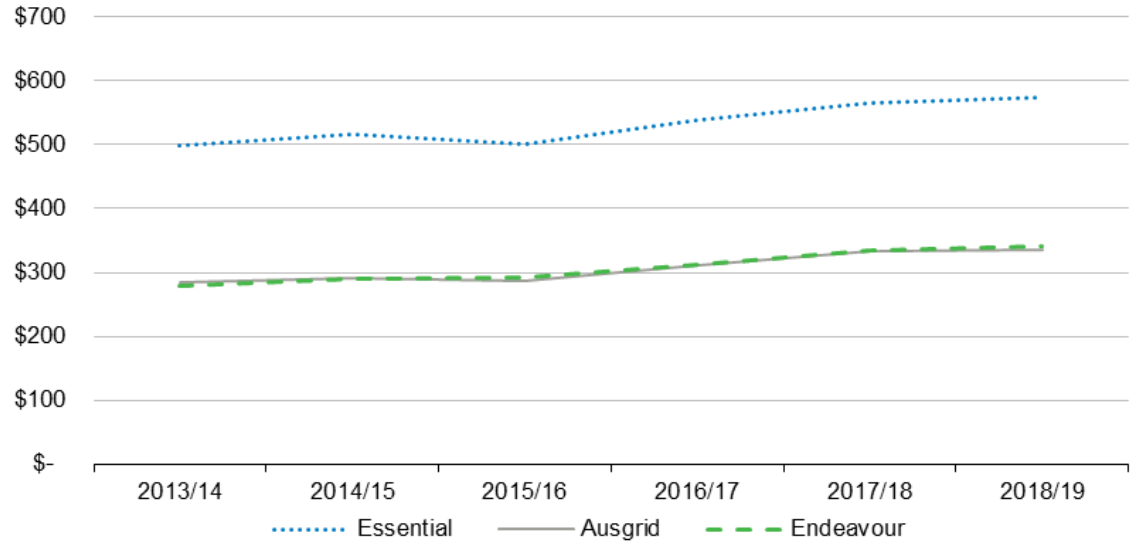
8.2.3 The fixed portion of residential bills has increased over time

As well as looking at the total increase in residential customer bills, we have analysed the individual bill components contributing to the broader price trend. Unlike consumption charges, customers cannot change this portion of their bill by reducing their electricity usage.

Since 2013-14 the average fixed proportion of residential customers' bills has increased by around $60, or 18% (Figure 8.2).

195 The AER determined network prices for the 2014-2019 regulatory control period. As part of transitional arrangements, the AER determined a placeholder revenue allowance for a transitional regulatory control period for 2014-15. When a lower revenue requirement was determined in 2015 for the 2014-2019 regulatory control period, this was reflected in network charges from 1 July 2015. In the full determination, the AER adjusted for the difference between the placeholder revenue allowance for the transitional year and the revenue requirement for the transitional year that was established in the full determination process. For example, see AER, *Ausgrid - Determination 2014-19*, https://www.aer.gov.au/networks-pipelines/determinations-access-arrangements/ausgrid-determination-2014-19, accessed 28 November 2017.

Figure 8.2 Change in the average fixed bill component over time, (5,100 kWh, nominal, GST-inclusive)



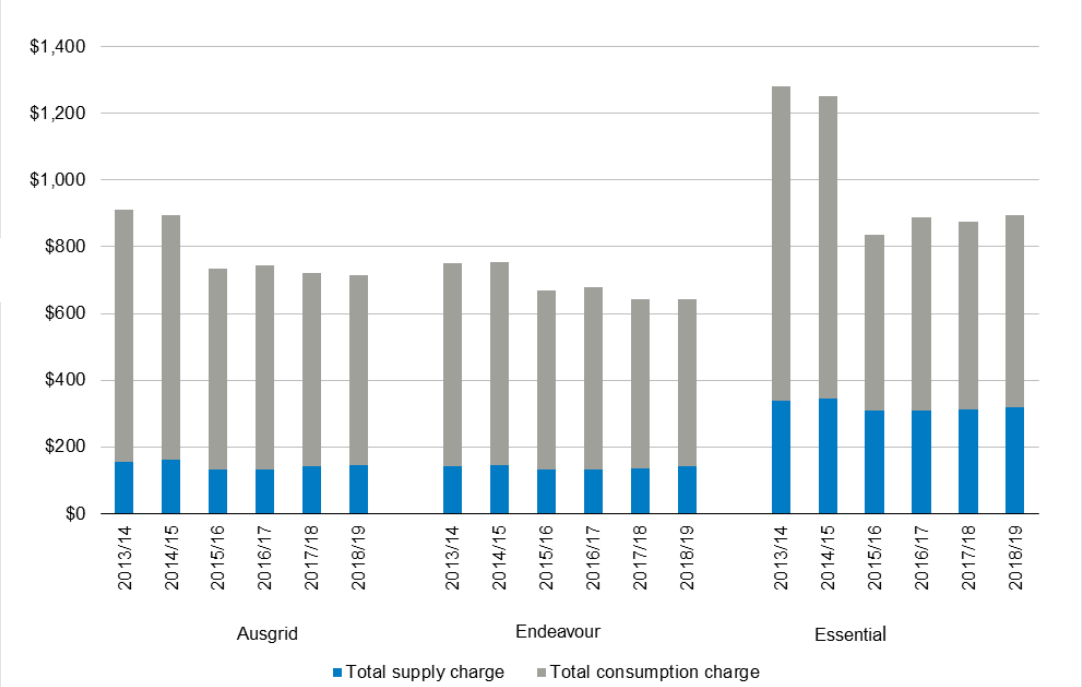
Data source: Energy Made Easy and information provided by retailers

The main fixed cost components of residential customers' bills are a portion of the network costs, and retail costs. Around 20% to 36% of residential network charges are fixed (Figure 8.3), while almost all of the retail component is fixed (because billing and marketing costs are the same regardless of how much electricity a customer uses).

The $60 increase in the fixed retail bill component does not reflect the change in the fixed network charges, which have fallen by an average of around $9, or 4% (Figure 8.3).

The increase in costs is largely a result of increases in wholesale electricity costs since 2013-14. Wholesale electricity costs would typically be considered variable costs, and so would be expected to be reflected in an increase in the variable component of retail prices, rather than the fixed component. However, retailers ultimately have discretion over how they recover their costs from retail tariffs.

Figure 8.3 Change in residential network costs over time, by fixed and consumption charges (5,100 kWh pa, nominal, GST-inclusive)



Data source: Ausgrid, *Price Lists and Policy, https://www.ausgrid.com.au/-/media/Documents/Regulation/Pricing/PList/Ausgrid-Network-Price-List-FY-201819.pdf*, accessed 19 September 2019; Endeavour Energy, *Our prices, http://endeavourenergy.com.au/wps/wcm/connect/e00d5bac-8adb-4d57-a525-540e1c2baf31/NUOS+Price+List_201819_v3.0.pdf?MOD=AJPERES*, accessed 19 September 2018; Essential Energy, *Electricity Network Pricing, https://www.aer.gov.au/system/files/Att.6%20Essential%20Energy%20Annual%20Network%20Pricing%20Report%202018-19_0.pdf*, accessed 19 September 2018.

We note that fixed network charges for residential customers have fallen slightly over the past few years. However recent changes to the National Energy Rules would likely result in a larger proportion of network costs being recovered from fixed charges, as network tariffs become more cost reflective.[196]

Draft Finding

11 The fixed proportion of residential customers' electricity bills has increased on average by 18% between 2013-14 and 2017-18, reflecting how retailers have chosen to recover their costs. This is a real increase in prices of 7.5% (once CPI is accounted for).

196 AEMC, *Distribution Network Pricing Arrangements*, http://www.aemc.gov.au/Rule-Changes/Distribution-Network-Pricing-Arrangements#, accessed 12 October 2017.

8.3 The spread of prices has increased since price deregulation

In addition to estimating the change in the average bill in each network area, we also looked at how different offers have changed since prices were deregulated.

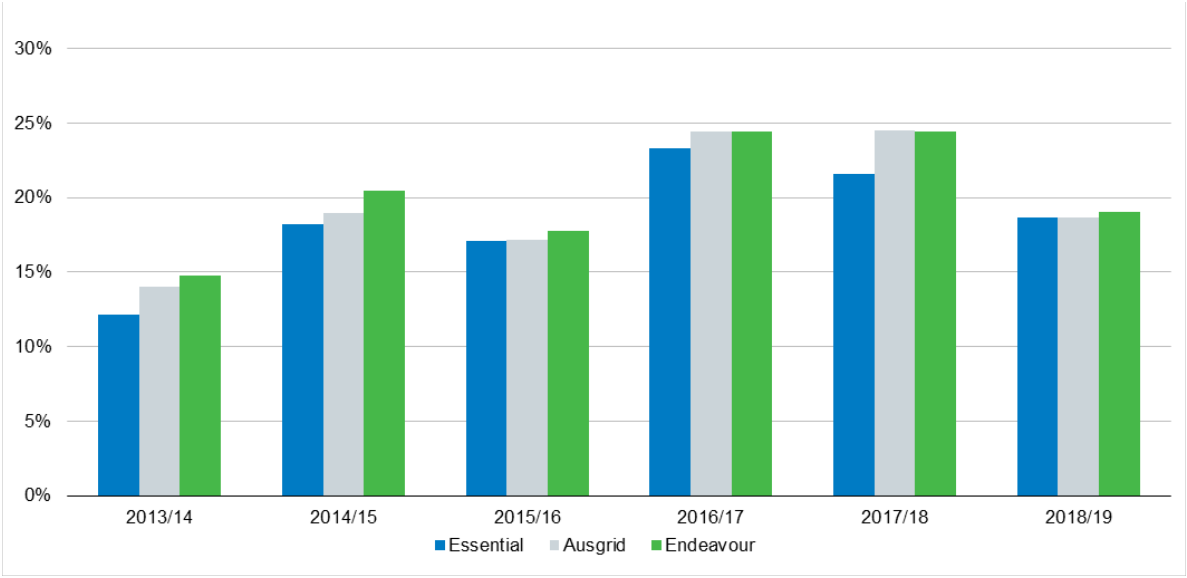
We found that for residential customers, standing offer prices have increased by around 15% to 17% in the metropolitan regions since price have been deregulated, while the lowest offers in the market have increased by around 9% to 11%. The standing offer in the Essential network has remained stable, while the lowest offer has decreased by 7.8%.

As discussed in Chapter 5, there is a substantial difference between the highest and lowest offers in the market. Figure 8.4 and Figure 8.5 show that the spread between retailers' lowest residential offers and their standing offers has increased over time.

In 2013-14, the average difference between the standing offer and the cheapest market offer for residential customers was 12% to 15%, or between $238 and $273 for a typical customer consuming 5,100 kWh per year. This increased to 24% or $479 in 2017.

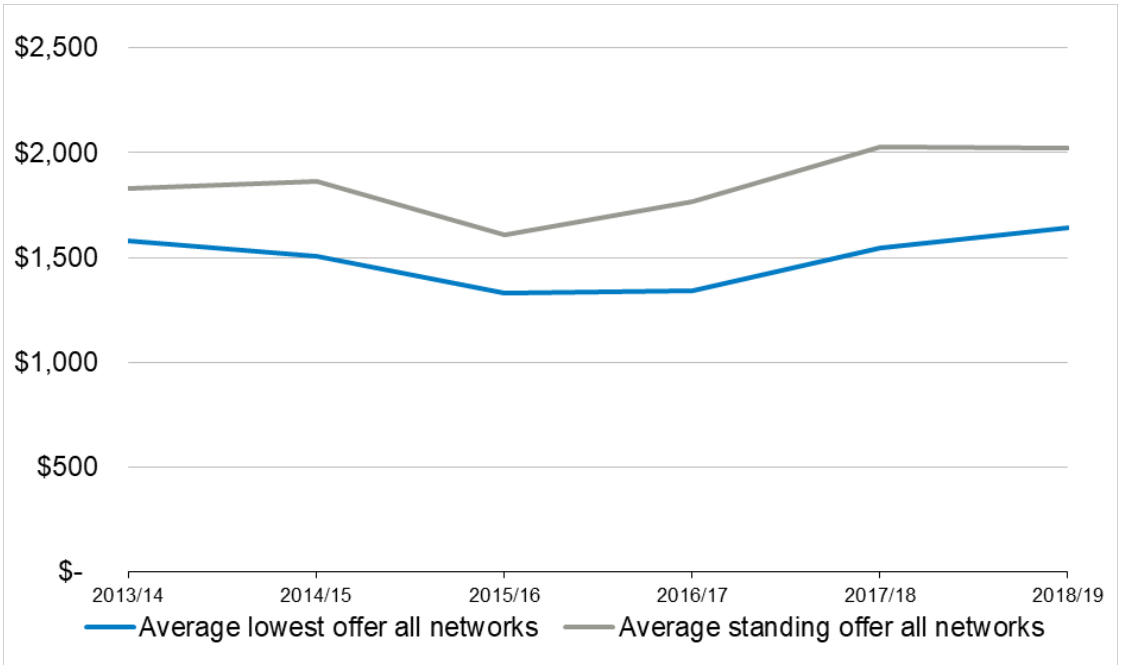
In July 2018, the highest offers in the market have remained constant, while the average lowest offers in the market have increased by 1.3%. As a result, the average difference between standing and lowest offers has narrowed slightly to around 19% in 2018-19. The represents a difference of around $365 for metropolitan areas and $420 for regional areas.

Figure 8.4 Difference between standing and lowest offers (5,100 kWh pa, nominal, GST-inclusive)



Data source: IPART calculations based on information from retailers, Energy Made Easy.

Figure 8.5 Average lowest and standing offer bills for a typical customer 2013-14 to 2018-19 (5,100kWh pa, nominal, GST-inclusive, average across all networks)



Data source: IPART calculations based on information from retailers, Energy Made Easy.

8.4 Bills for small business since price deregulation vary for small business customers

Bills for business customers will vary significantly depending on the type of business they operate.[197]

We considered the annual bill for the small business customers consuming 10,000 kWh per year. We found that these customers with the big 3 retailers are likely to pay between $3,000 and $5,000 in each year. As with residential customers, there is also substantial variation in prices for small business customers depending on the type of offer (Table 8.4).

197 Businesses are classified as small electricity customers if they consume less than 100,000 kWh per year.

Table 8.4 Typical bills for small business customers (10,000 kWh pa, nominal, GST-inclusive, based on offers of the big three retailers)

Network	2013-14 – Regulated tariff	Offer type	2014-15	2015-16	2016-17	2017-18	2018-19
Ausgrid	$3,374	Lowest	$2,788	$2,696	$3,100	$3,585	$3,462
		Most common	$2,841	$2,799	$3,124	$3,620	$3,410
		Standing	$3,238	$3,165	$3,727	$4,462	$4,477
Endeavour	$2,993	Lowest	$2,328	$2,219	$2,432	$2,826	$2,903
		Most Common	$2,462	$2,368	$2,453	$2,855	$2,790
		Standing	$2,771	$2,720	$2,993	$3,564	$3,565
Essential	$4,567	Lowest	$3,763	$3,091	$3,397	$3,796	$3,671
		Most Common	$3,924	$3,141	$3,491	$3,834	$3,752
		Standing	$4,395	$3,770	$4,158	$4,753	$4,757
Weighted average all networks	$3,568	Weighted average	$3,168	$2,935	$3,286	$3,818	$3,769

Note: Retailers' lowest offers are based on the lowest publicly available offer at the end of July. However the offer that has the most customers ('most common offer') may be expired. As a result the most common offer can be lower than the lowest offer.

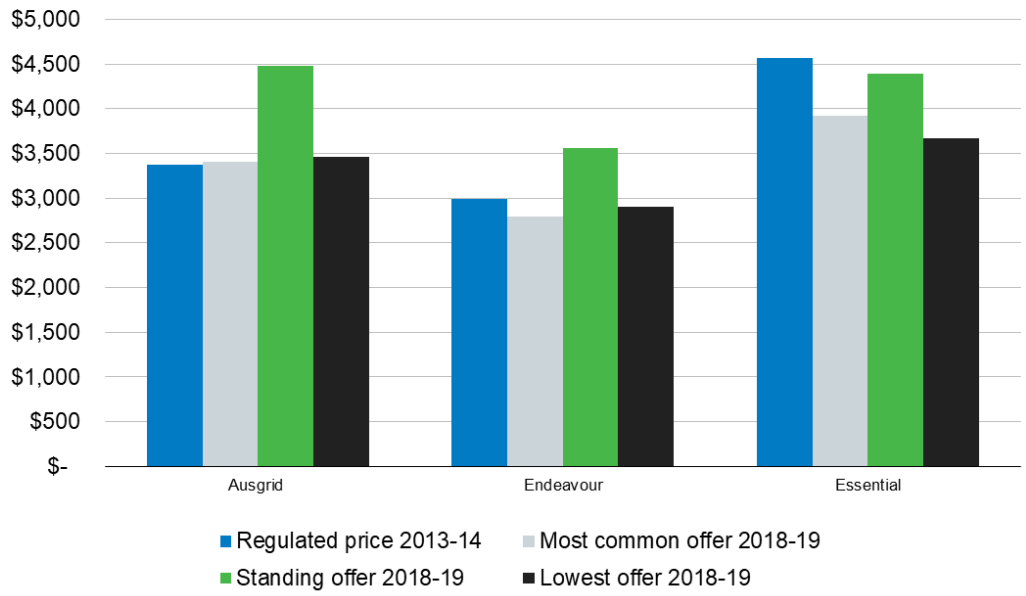
Source: IPART calculations based on information from retailers, Energy Made Easy.

We compared the average most common offer in 2018-19 of each of the big three retailers with the regulated price in 2013-14, immediately before prices were deregulated (see Figure 8.6). We also compared the current average standing offer price with the regulated price in 2013-14.

We found that:

- In the Ausgrid network, the most common offer in 2018-19 is around 1% higher than the regulated price in 2013-14, while the standing offer was around 33% more expensive.
- In the Endeavour network, the most common offer is 7% lower than the regulated price in 2013-14, while the standing offer was 19% higher, and
- In the Essential network, the most common offer is around 18% lower when compared to 2013-14, while the standing offer is around 4% higher. As discussed above, the substantial price decreases over time in the Essential network are largely due to reductions in network costs.

Figure 8.6 Changes in business bills since 2013-14 by network and offer type



Data source: IPART calculations based on information from retailers, Energy Made Easy.

Draft Finding

12 Since price deregulation, the bill for a typical Ausgrid small business customer has increased by 1%, and decreased by 7% and 18% in the Endeavour and Essential network respectively (comparing the most common offers currently in the market to the regulated prices in 2013-14). These are all price reductions in real terms.

9 Measures to improve customer outcomes

Retailers are currently required to follow a large number of rules and regulations when supplying small customers with electricity and gas (Box 9.1).

This chapter outlines our views on whether additional government measures would help improve customer outcomes, and their impact on competition.[198]

Box 9.1 Regulations governing the retail energy market

Although electricity prices were deregulated in NSW in 2014, there are still a large number of rules and regulations that retailers have to follow when supplying small customers with electricity.

In July 2013, the NSW Government adopted the National Energy Customer Framework, which sets out consumer protections and operates alongside the Australian Consumer Law to protect small energy customers in their electricity supply arrangements. It replaced most state-based rules that were different in each jurisdiction. For example, it governs consumer protection measures, mandatory minimum terms and conditions for market retail contracts for all small customers, retailer hardship policies and limitations on disconnections, including processes to follow and restrictions on when disconnections can occur.

As well as ensuring that all customers, regardless of where they live, receive the same level of consumer protections, a consistent set of rules across most states and territories reduces the operating costs for retailers, resulting in more competitive prices for consumers. As discussed in Chapter 3, a different sets of rules between states and territories can discourage retailers from entering other retail markets because there are costs involved with understanding and complying with each different set of regulations, increasing barriers to entry.

Source: IPART, *Review of the performance and competitiveness of the retail electricity market in NSW, From 1 July 2016 to 30 June 2017*, November 2017, p 67.

9.1 Overview of draft findings

In our view, competition should drive the best outcomes for customers in the retail electricity and gas markets. Where competition is effective, the ability for customers to shop around protects them from paying prices that are too high.

We consider that there is a role for governments to ensure that the market framework supports customer engagement. As discussed in Chapter 5, both the Federal Government and the NSW Government have recently introduced many measures in a short space of time to help ensure that customers who want to shop around are able to do so effectively.

We consider that a non-binding benchmark tariff could also assist customers to assess the value of different offers, without reducing levels of customer engagement or creating additional risks for retailers. On the other hand, re-introducing price regulation or a 'default tariff' is likely over time to lead to lower levels of competition and higher prices.

198 Section 234A(3)(f) of the *National Energy Retail Law (NSW)* requires us to report on the steps necessary to improve the competitiveness of each market if we are of the opinion that it is required.

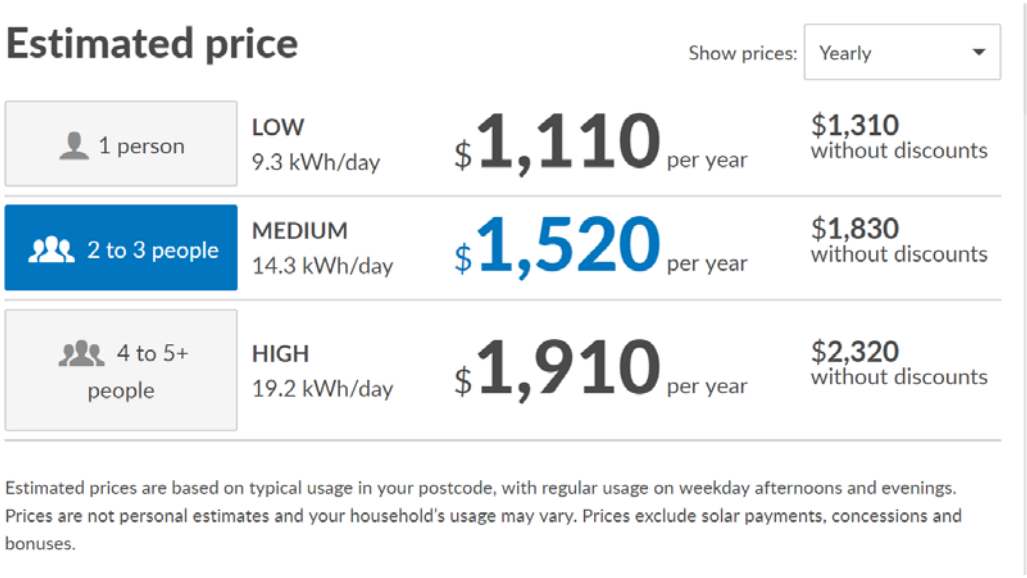
9.2 A benchmark tariff would be less problematic than a regulated tariff

A non-binding benchmark could provide customers with a tool to assess how an offer compares with the benchmark to help them to determine whether it is a 'good' deal. The benchmark tariff would need to be set for each network and would be used to estimate bills for different consumption levels. It would make it easier for customers to engage in the market, maintaining competitive pressure on retailers. This would deliver increased customer engagement, without creating additional risks for retailers.

As mentioned in Chapter 5, new requirements commenced on 31 August 2018 which set out how retailers must present their offers to customers.[199] Retailers' 'Basic plan information document' now includes an annual bill comparison table for different consumption levels so that customers can compare between offers without having to make any calculations.[200] The benchmark tariff could be included in this basic plan document as part of the annual bill comparison table (Figure 9.1). Benchmark bills could also be included as a reference point on customers' bills.

However, stakeholders have submitted that before introducing additional requirements, the impacts of the recent changes should be monitored.[201] We agree that a benchmark tariff would not appear to be warranted at this time, given the additional measures to assist customers that have been implemented.

Figure 9.1 Example of the annual bill comparison table on the basic plan document



Source: Energy Made Easy.

199 AER, *Retail Pricing Information Guidelines 2018,* https://www.aer.gov.au/retail-markets/retail-pricing-information, accessed 26 September 2018.

200 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 109.

201 Australian Energy Council submission to IPART Information Paper, August 2018, p 2; EnergyAustralia submission to IPART Information Paper, August 2018, p 2, Simply Energy submission to IPART Information Paper, August 2018, p 2.

A binding default tariff would be an alternative to a benchmark tariff. In the short term a default tariff could help disengaged customers avoid paying excessive prices. However, over time it is likely to result in less customers actively shopping around in the market as the benefits from switching fall.

In its most recent survey of residential customers in 2017, the AEMC found that to consider switching retailer or plan, customers would want to save an average of $364 per year on their electricity bill.[202] For a typical annual bill of $1,832, this equates to more than a 20% price reduction, which is larger than the difference between standing offers and the cheapest offers in the market. This indicates that if a default tariff was set with a lower price differential compared to the current differential between standing and market offers, it would not be a sufficient incentive for many customers to engage in the market.

Lower levels of customer engagement is also consistent with the experience of the jurisdictions (both in Australia and around the world) that have maintained government price controls. In these jurisdictions, a significantly higher proportion of customers pay the higher regulated rates, and only the most price sensitive customers engage in the market.[203]

In the longer term, a smaller market for 'active' customers is likely to lead to fewer retailers competing in the market. This is likely to lead to less vigorous competition and innovation and higher prices (Figure 9.2).

Figure 9.2 Impact of price regulation

A benchmark tariff is advantageous not only because it facilitates customer engagement, but also for providing flexibility for retailers. For example, a binding default tariff creates a risk to retailers' viability if the regulator's forecasts are lower than their costs. This risk can be non-trivial, particularly for smaller retailers. These increased risks can increase the underlying costs of supply. On the other hand, a non-binding tariff could avoid this risk.

Importantly, neither a binding default tariff, nor a non-binding benchmark would necessarily result in lower prices. If the underlying costs of supply were to increase, then the default and benchmark tariff would also increase. To illustrate, the largest electricity price increases that occurred in NSW over a sustained period was between 2007-08 and 2013-14, when retail prices were regulated. These increases were driven by large increases in network costs.

202 Small business customers would want to save about $1,284 a year. Newgate Research, *Consumer Research for the Australian Energy Market Commission's 2017 Retail Competition Review*, April 2017, pp 38, 46-47; AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 124.

203 For example, see KPMG, *Energy retail markets, An international review*, April 2017, pp 7-8.

Since 2013-14, network costs (which make up around 40% of the bill) have fallen by 23%. However these cost reductions have been offset by significantly higher wholesale costs in 2016 and 2017. Wholesale costs rose due to increasing gas costs and less supply following the closure of Hazelwood power station.

Therefore the most effective way of limiting further prices increases in the future is to provide conditions to encourage new investment in the wholesale market to increase supply and replace existing generation as they reach the end of their asset lives. This means providing a stable and predictable investment environment.

Network prices are expected to continue to fall in real terms, and more can also be done to keep network prices as low as possible in the future. For example, to avoid future over-investment in the network, which has been a key cause of higher bills, Governments should set distribution reliability standards using an economic framework that balances the cost of reliability with the value that customers place on it.

9.2.1 Assisting low-income customers

We considered whether a default tariff should be accessible to low-income customers (for example, Healthcare card holders) to protect them from higher prices.

In our view, a restricted default tariff would be preferable to a generally available default tariff to limit the adverse impacts on competition. A default tariff for low-income customers is also less likely to affect the incentives for these customers to participate in the market (where they have capacity) than the average customer because they are likely to be more price sensitive (and any savings are a higher proportion of their overall disposable income).

However, we do not consider that a default tariff for low-income customers should be introduced at this time, as new measures to assist low-income customers have recently been implemented in NSW.

In December 2017 the NSW Government introduced new obligations on retailers to help low-income customers move onto lower market offers. Retailers are required to use all reasonable endeavours to inform and assist any customer receiving a rebate to identify the most appropriate market offer for that customer at six month intervals. Retailers are required to report six monthly on the measures taken to move rebate customers to market offers, the effectiveness of these measures (ie how many customers have change offers), and how much these customers save as a result.[204]

We also note that Service NSW has also been given a role to help customers choose their retailer.[205]

[204] NSW Social Programs for Energy Code, December 2017.

[205] NSW Government, *NSW Budget: 'One-click energy switch' could save households more than $1000 a year*, June 2018, https://www.nsw.gov.au/your-government/the-premier/media-releases-from-the-premier/nsw-budget-one-click-energy-switch-could-save-households-more-than-1000-a-year/, accessed 26 September 2018.

9.3 Requiring retailers to discount from a benchmark offer has trade-offs

Discounting continues to be a common practice, with only 20% of offers in the market having no discounts attached to them.[206] However, as explained in Chapter 4, the headline discount is not an effective way of assessing the value of an offer, because the overall bill also depends on the underlying tariff. An offer with no discount and low tariffs could lead to a lower bill than an offer with a very high discount, and high underlying tariff rates.

We considered whether retailers should calculate their headline discounts from a common tariff (ie a benchmark tariff) to make them comparable across offers. However, this is not straightforward in practice because the discount level can change depending on the level of consumption used to calculate the discount (because the relativities between the different tariff components can vary).

One option would be for retailers to calculate the headline discount using the average level of consumption. This would make these offers easier to compare for customers using the average amount of electricity. However, it could mean that the headline discounts for other customers with higher or lower consumption compare poorly, even if these customers would be better off on these offers (Box 9.2).

As a result, offers that are tailored to particular customer segments are less likely to be offered, limiting product innovation and options available to "non-average" customers, making these customers worse off.

By making it more difficult to compete for "non-average" customers, the innovation and competitive edge offered by new retailers would also be diminished. Further, through intensified price-competition for "average" customers, smaller retailers might struggle to compete against the larger incumbents that benefit from economies of scale.

206 AEMC, *2018 Retail energy competition review*, Final report, June 2018, p 54.

Box 9.2 Requiring customers to use the benchmark tariffs to calculate a headline discount

This example shows three offers that are tailored to different households: small, medium, and large. The highlighted cells show the best offers depending on the household size. It shows that a low consumption household (3,000 kWh per year) would be best off on offer 2, which has a low supply charge, and a higher usage tariff. A high consumption household (using 9,000 kWh per year) would be better off on offer 3, which has a highly daily usage charge, and a low consumption tariff.

Offer	Daily supply charge	Consumption tariff	Bills for different households		
			Consumption (kWh pa)		
	c	c/kwh	**Low (3,000)**	**Average (5,100)**	**High (9,000)**
Benchmark offer	95.0	32.4	$1,319	$2,000	$3,264
Offer 1	85.5	29.2	$1,187	$1,800	$2,938
Offer 2	30.0	34.0	$1,130	$1,844	$3,170
Offer 3	300.0	16.0	$1,575	$1,911	$2,535

Requiring retailers to calculate the headline discount using the consumption profile for the average customer using 5,100 kWh per year would mean that offer 1 would have the highest headline discount rate at 10%. Offers 2 and 3 would compare less favourable with headline discounts of 8% and 4% respectively, even though a low user would save 14% on offer 2, and the high energy user would save 22% on offer 3. While the average household would be able to compare these offers more effectively, the non-average households would be worse off.

	Discount by consumption level		
	Consumption, (kWh pa)		
	Low (3,000)	**Average (5,100)**	**High (9,000)**
Offer 1	10%	10%	10%
Offer 2	14%	8%	3%
Offer 3	-19%	4%	22%

Appendices

A IPART's statutory role

National Energy Retail Law (NSW) No 37a

234A—Market Monitor

(1) In this Part, the Market Monitor is the person prescribed by the NSW regulations as the Market Monitor for the purposes of this Part.

(2) The Market Monitor is to monitor the performance and competitiveness of the retail electricity market and the retail gas market in New South Wales for small customers.

(3) The Market Monitor is to report annually to the Minister on the performance and competitiveness of each of the retail electricity market and the retail gas market in New South Wales for small customers, including on the following matters—

(a) the participation of small customers in each market and, if the Market Monitor thinks it appropriate, particular groups of small customers;

(b) prices of electricity or gas for small customers in regional areas;

(c) any barriers to entry to or exit from, or expansion, in each market;

(d) the extent to which retailers are competing to attract and retain small customers;

(e) whether price movements and price and product diversity in each market are consistent with a competitive market;

(f) if the Market Monitor is of the opinion that it is required, steps necessary to improve the competitiveness of each market;

(g) whether there is a need for a detailed review of retail prices and profit margins in each market;

(h) any other matters the Market Monitor thinks appropriate.

(4) An annual report is to be prepared for each year commencing on 1 July.

(4A) The first annual report for the retail gas market is to be for the year commencing 1 July 2017.

(5) The annual report is to be provided to the Minister not later than 30 November following the end of the year to which the report relates.

(6) The Minister is to lay the annual report or cause it to be laid before both Houses of Parliament of this jurisdiction not later than 30 days after receiving the report.

(7) In preparing an annual report, the Market Monitor is to have regard only to the following—

(a) information provided by the AEMC and the AER;

(b) any publicly available information;

(c) information provided by a retailer under subsection

(8) The Market Monitor may, by notice in writing served on a retailer, require the retailer to provide particulars to the Market Monitor of the number of market offer customers of the retailer, the market offer prices of those customers, the number of customers on each standing offer price offered by the retailer that has been publicly advertised and those standing offer prices.

B Letter from the Minister – 27 June 2017

Don Harwin MLC
Minister for Resources, Minister for Energy and Utilities,
Minister for the Arts, Vice-President of the Executive Council

Our ref: V18/1181

Dr Peter Boxall AO
Chair
Independent Pricing and Regulatory Tribunal
PO Box K35
HAYMARKET POST SHOP NSW 1240

Dear Dr Boxall

I am writing regarding the Independent Pricing and Regulatory Tribunal's (IPART) 2018 Retail Energy Market Monitor review.

I was pleased to see in your December 2017 *Review of the performance and competitiveness of the retail electricity market in NSW* that competition for residential and small business electricity customers continues to improve. Ensuring energy affordability and customer choice is a key commitment of the NSW Government.

I would also like to thank IPART for its recommendation in the December 2017 report for retailers to give advanced notice to customers of price changes. As you may be aware, I have recently submitted a joint rule change, with the Hon Josh Frydenberg, Minister for the Environment and Energy, requesting the Australian Energy Market Commission change the national rules to this effect. The Commission has recently started this rule change process.

It is essential that competition in NSW energy markets continues to develop. In previous years, I have requested IPART to review price changes that occur in July each year to ensure that these changes are efficient. IPART's advice on these matters is key to ensuring that customers continue to have confidence in the markets. I am therefore requesting that IPART reviews electricity and gas price movements in July 2018 and advises on whether any price changes reflect efficient costs in a competitive market. IPART should also consider any relevant issues that are raised in the Australian Competition and Consumer Commission's Retail Electricity Pricing Inquiry: Final Report.

In addition, you would be aware that changes to the national rules on metering commenced on 1 December 2017. Digital meters can bring significant benefits to customers by helping them to control their electricity costs and to increase market efficiency by improving network usage.

It is essential that the transition to the new arrangements is as smooth as possible to ensure ongoing consumer confidence in the market. I expect retailers to deliver high levels of customer service; however, I have heard reports of delays in meter installation and poor customer communication.

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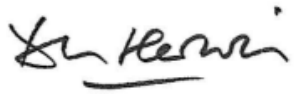
In this context, I request that IPART review retailers' practices in relation to metering and report on whether these practices are delivering acceptable levels of customer service. This may require IPART to formally request information from retailers about its metering performance, including timeframes for the installation of meters since the new arrangements commenced. In its 2018 report, I also ask that IPART identify any opportunities or recommendations for improving retailer customer service.

Both requests are made under section 234B of the National Energy Retail Law (NSW) and I request that you consider these as part of the annual report. Should you have further questions on this matter, please contact Ms Katharine Hole, Executive Director Energy Strategy on 02 8229 2848.

Yours sincerely



Don Harwin MLC
Leader of the Government in the Legislative Council
Minister for Resources
Minister for Energy and Utilities
Minister for the Arts
Vice-President of the Executive Council

Date: 7 May 2018