IPART

Independent Pricing and Regulatory Tribunal
New South Wales

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

From 1 July 2017 to 30 June 2018

Final Report

Energy

November 2018

ISBN 978-1-76049-265-6

The Independent Pricing and Regulatory Tribunal (IPART)

IPART provides independent regulatory decisions and advice to protect and promote the ongoing interests of the consumers, taxpayers and citizens of NSW. IPART's independence is underpinned by an Act of Parliament. Further information on IPART can be obtained from IPART's website: https://www.ipart.nsw.gov.au/Home.

Tribunal Members

The Tribunal members for this review are:

Dr Peter J Boxall AO, Chair

Mr Ed Willett

Ms Deborah Cope

Enquiries regarding this document should be directed to a staff member:

Jessica Robinson (02) 9290 8405

Courtney Barry (02) 9113 7732

Contents

Tribunal Members iii

1 Executive summary 1

1.1 Overview of key findings and recommendations 1
1.2 Key indicators suggest competition continued to increase in 2017-18 2
1.3 Changes in electricity and gas prices into 2018-19 reflect efficient costs in a competitive market 4
1.4 Average electricity bills have fallen slightly in real terms since price deregulation in July 2014 6
1.5 Bills for metro customers on standing offers have increased in real terms since price deregulation 8
1.6 Governments and regulators are implementing wide-ranging measures to help customers engage in the market 9
1.7 A regulated “default offer” is likely to lead to higher prices in longer term 11
1.8 Structure of this report 12
1.9 List of recommendations and findings 12

2 Context and approach 15

2.1 IPART’s market monitoring role 15
2.2 Special reviews conducted as part of this role 18
2.3 Our process for this review 18
2.4 Other regulators’ monitoring roles 19
2.5 Recent findings of other regulators 21

3 No substantial barriers to entry 23

3.1 Overview of findings 23
3.2 Large number of retailers contesting the electricity market 24
3.3 Retail electricity market remains relatively concentrated 26
3.4 Increasing number of retailers active in gas markets 33
3.5 Number of active gas retailers varies by network area 34
3.6 Pipeline arrangements and high wholesale prices may be deterring further entry into the gas retail market 36

4 Retailers are competing to retain and attract customers 40

4.1 Overview of findings 40
4.2 All-day tariffs are the most common structure but more cost-reflective price structures are available 40
4.3 Wide variation in electricity price offerings 43
4.4 Discounts to standing offers the main way to attract customers 48
4.5 Most retailers are not using price to target different customer segments 50
4.6 Retailers are differentiating their product offerings 53

5 Customers are relatively engaged and active 55

5.1 Overview of findings 55
5.2 Customer participation in electricity market remained high in 2017-18 56
5.3 Customers participation in the gas retail market increased 57

5.4 Difficulty of comparing offers continued to constrain customer engagement 58

6 Electricity prices broadly reflect the cost of supply 62

6.1 Overview of findings on changes in electricity prices 62
6.2 Prices remained relatively flat in to 2018-19 62
6.3 Underlying costs of supplying electricity fell into 2018-19 67
6.4 Changes in prices reflect changes in the underlying costs of supply 72
6.5 Detailed review of profit margins is not necessary 73

7 Price outcomes vary by network area 75

8 Gas prices are becoming more efficient 82

8.1 Overview of findings 82
8.2 Coastal prices were relatively unchanged from June 2018 to July 2018 82
8.3 Country prices decreased between June 2018 and July 2018 84
8.4 Gas costs have increased by between 2% and 6% 86

9 Transitional measures to support competition are required 91

9.1 Overview of findings and recommendations on measures to support competition 91
9.2 New measure to limit retention and win-back activity by big three retailers necessary to support competition 93
9.3 A non-binding reference tariff could assist customers but it is not warranted at this time nor without risks 98
9.4 Default tariff could lower prices for disengaged customers in short term but lead to higher prices for all in long term 102
9.5 Default tariff for low-income customers could assist these customers but not warranted at this time 104

Appendices 109

A IPART's statutory role 110

B Letter from the Minister 112

C Data Tables 114

1 Executive summary

Over the past 16 years, retail energy markets in NSW (as in most parts of Australia) have transitioned from monopolies – with no customer choice and full price regulation – to competitive markets – with a choice of retailers and energy plans – and full price deregulation. This transition has occurred in stages, with strong government oversight and non-price regulation aimed at ensuring better customer outcomes by putting downwards pressure on price and costs through competition, while providing consumer protections. Allowing competition to continue to develop would deliver the best outcomes for customers in NSW.

The Independent Pricing and Regulatory Tribunal of NSW (IPART) is one of a range of regulators providing this oversight, as part of our role as the state's electricity Market Monitor.[1] In this role, and at the request of the NSW Minister for Energy and Utilities (the Minister), we have completed a review of:

- The performance and competitiveness of NSW energy retail markets in the year 2017-18
- The changes in retail electricity and gas prices in July 2018 (ie, into the year 2018-19), and whether these changes reflect efficient costs in a competitive market
- Relevant issues raised by the Australian Competition and Consumer Commission in its *Retail Electricity Pricing Inquiry: Final Report*.[2]

The report sets out our final findings on each of these matters. As in previous years, one of our key challenges in this review was isolating the impact of retail market competition on retail energy prices. These prices are influenced by many factors, not only the behaviour of retail energy suppliers. For example, they are affected by price changes in the generation and distribution sectors of the market – that is, the underlying wholesale and network costs of electricity. In turn, these price changes are influenced by changes in the broad energy market, policy and regulatory environment.

1.1 Overview of key findings and recommendations

Overall, competition for residential and small business customers in NSW retail energy markets is continuing to develop and is delivering benefits to customers. Governments should continue to actively support customers in engaging in the market to place more pressure on retailers to offer competitive prices and services for the benefit of customers. On the other hand, re-regulating prices is likely to lead to higher prices in the longer term. We have found that:

1 *National Energy Retail Law (NSW)*, s 234A; National Energy Retail Law (Adoption) Regulation 2013, cl 8A.

2 The Minister also asked us to review whether retailers are providing acceptable levels of customer service in relation to metering. Our findings on this review are set out in a separate report, *Retailers' metering practices in NSW.*

- Each of the key indicators we use to assess competition in the electricity and gas retail markets were steady or suggested competition increased in 2017-18 compared to the previous year.
- The changes in electricity and gas prices into 2018-19 reflected efficient costs in a competitive market.
- Electricity prices are significantly higher than they were 10 years ago, but these increases occurred when prices were still regulated, driven by rising regulated network prices. Since 2013-14 (the last year of price regulation), average electricity bills across NSW have fallen in real terms in line with the net impact of fluctuations in the underlying costs of electricity.
- However, bills for some 17% of customers – those who have not actively engaged in the market and are on 'standing offers' – are around 26% higher than the lowest offers in the market.
- Governments and regulators are already implementing a wide range of measures to help customers engage in the market and put pressure on retailers to offer lower prices, and these are having a positive effect.
- A further transitional measure should be implemented to support competition. Retailers should be prohibited from engaging in retention and 'win-back' activities for six months after a customer has switched retailers, and this measure should be in place for three years while competition continues to develop. This would help smaller retailers grow their customer base so they can compete more effectively over the longer term. It would also put competitive pressure on the big three retailers to proactively offer their 'sticky' customers cheaper prices.

In our view, the most effective way governments can ensure sustainable retail energy prices in the future is to provide a stable and predictable energy market framework. This stability will encourage new investment in the wholesale market, which is essential to increase supply and replace existing generation as it reaches the end of its asset life.

Our findings and recommendations are outlined in more detail in the sections below.

1.2 Key indicators suggest competition continued to increase in 2017-18

Every year since electricity prices were deregulated in 2014, we have assessed competition in the retail energy markets using key indicators. In 2017-18, like in all other years, we found that each of these indicators either remained steady or improved compared to the previous year in NSW (Table 1.1). For example:

- The number of retail businesses active in the NSW electricity market increased by three during 2017-18. This brought the total number to 24, which is 11 more than when electricity price deregulation occurred.
- In the NSW retail gas market, the number of active retail businesses remained steady at nine, three more than since gas price deregulation occurred on 1 July 2017. All were active in the Jemena distribution network, where 95% of small retail gas customers are located. The 10 smaller gas networks[3] had up to three active retailers each.

3 Such as Wagga Wagga, Albury and Queanbeyan.

- Customer engagement increased in both markets, with higher percentages of electricity and gas customers switching retailers compared to the previous year. The number of electricity customers who moved from standing offers to market offers also increased substantially, bringing the proportion on market offers to 83%, compared to 78% last year. This suggests many customers engaged with the market for the first time during 2017-18 (at least at their current address).

Table 1.1 Changes in key indicators of competition in the NSW energy markets

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 smaller retailers (residential and business customers)	4%	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 smaller retailers (residential and business customers)	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.

While retailers have continued to enter the market, the pace at which these smaller retailers gained market share has remained slow. In its recent Retail Electricity Pricing Inquiry, the Australian Competition and Consumer Commission (ACCC) found that smaller retailers may find it harder to enter and expand their businesses 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 electricity market (NEM) has reduced the availability of hedging contracts relied upon by smaller retailers, and there are now very few suppliers of load-following hedges.[4]

The ACCC also found that 'the big three' retailers (AGL, Origin, and EnergyAustralia) have a particular financial advantage over smaller retailers. This allows them to undertake aggressive retention and win-back strategies when their customers decide to switch retailers, and this is significantly affecting the ability of smaller retailers to gain scale in the market.[5] The ease with which a customer can be retained or won back also reduces the incentives on the incumbents to give their long-standing customers better prices or services.

Unlike the smaller retailers, the big three purchased a large proportion of their customers from government retailers, rather than 'winning' them. This means they have a larger proportion

4 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 150.
5 *Ibid*, pp 151-153.

of 'sticky' customers who have never engaged in the market, and so are less likely to switch retailers in the future. As a result the big three retailers are able to charge these customers higher prices, and recover a greater proportion of their fixed and sunk costs from them.[6] This gives them a particular price advantage for new customers that goes beyond the normal scale advantages of incumbents. It enables them to offer very cheap retention or win-back offers to their customers who decide to switch retailers.

After considering the ACCC's findings on the big three's competitive advantages, we are recommending the NSW Government submit a transitional rule change to the Australian Energy Market Commission (AEMC) to prohibit retailers from engaging in retention and win-back activities for six months after a customer has switched retailers. This would support competition while the market is developing by helping smaller retailers grow their customer base[7] so they can compete more effectively over the longer term. It would also put competitive pressure on the big three retailers to proactively offer their 'sticky' customers cheaper prices by reducing their ability to rely on retention and win-back strategies to keep these customers. We suggest that such a rule should be in place for three years while the market continues to develop.

1.3 Changes in electricity and gas prices into 2018-19 reflect efficient costs in a competitive market

Energy retailers typically change their prices in July, when the network businesses change their network tariffs.[8] In July 2018, many electricity retailers held their prices constant, while others increased them only slightly. We estimate the average electricity price increase for residential and business customers across NSW was 0.2%, relative to prices in June 2018 (Table 1.2).

Similarly, the average gas price increase in the Jemena network was 0.2% for residential customers, and 1.7% for business customers. In the country gas networks, prices fell by an average of around 2% for both residential and business customers (Table 1.2). This varied between networks, with prices for AGN Adelong, Gundagai and Tumut falling by around 14%, while the standing offers in the Shoalhaven and Queanbeyan networks increased by around 6%.

6 The ACCC found that in NSW, 40% of the revenue from residential customers of the big three retailers comes from the 20% of customers on higher standing offers, compared to 3% of revenue of the smaller retailers earned from the 2% of their standing offer customers. The revenue for the big three retailers is an average of $150 higher per customer (around 10%). *Ibid*, pp 142, 242-243.

7 This is because it would mean small retailers are less likely to lose new customers to retention and win-back offers of the big three retailers.

8 Although they can also change prices at any other time subject to the terms of their contracts.

Table 1.2 Average retail price changes, June 2018 to July 2018

	Residential	Business
Electricity	0.2%	0.2%
Gas (Jemena)	0.2%	1.7%
Gas (Country)	-2.3%	-1.7%

Source: IPART calculations based on information from Energy Made Easy and retailers. Average retail price changes are weighted by offer and by number of customers in each network area except for country gas which is weighted by retail offers but is a simple average across networks.

To assess whether these retail price changes are consistent with efficient costs in a competitive market, we analysed the changes in the underlying costs of supply. We found that:

- The electricity price changes reflect the underlying costs of supply, as retailers have smoothed the impact of the large increase in wholesale costs in 2017-18 over two years.
- The gas price changes in the Jemena region reflect the underlying costs of supply, while those in country areas are becoming more cost-reflective.

1.3.1 Electricity price changes reflect the underlying costs of supply

We estimated that the forecast cost of supplying electricity to customers in 2018-19 decreased by around 10%. This is because:

- Forward wholesale prices (which made up around 30% of the average electricity bill in 2017-18) decreased significantly, by around 35% (when we look at the average forward prices in June 2017, compared to June 2018)
- Network costs (which made up 40% to 50%) 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
- Green costs (which made up around 6%) increased by around 16% (mainly due to 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).

Even though prices remained stable while costs fell for 2018-19, we consider that average prices currently reflect the level of underlying costs. This is because retailers have smoothed the impact of wholesale cost changes on bills in 2017-18 over two years.

Wholesale costs increased sharply by around 140% in 2017-18 and decreased by around 35% in 2018-19. We found that the cumulative change in wholesale costs across the two years (around 50%) is likely to have added around 12% to the average costs of supply. 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 that other cost components also changed).

1.3.2 Gas price changes reflect the underlying costs of supply or are becoming cost-reflective

We estimate that the forecast costs of supplying gas (excluding retail costs) in the Jemena region increased by 2.3% in 2018-19. This increase was mainly driven by a 13.4% 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 – an average of 3.9% - mainly because wholesale costs make up a larger proportion of the total costs of supply in country areas (Table 1.3).

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. In some country areas, some prices may exceed the costs of supply, but they 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	23%	13.4%	3.1%	26%	13.4%	3.4%
Transmission costs	10%	2.3%	0.2%	9%	2.4%	0.2%
Distribution costs	41%	-2.5%	-1.0%	29%	-4.9% to 4.8%	0.3%
Total cost change			**2.3%**			**3.9%**

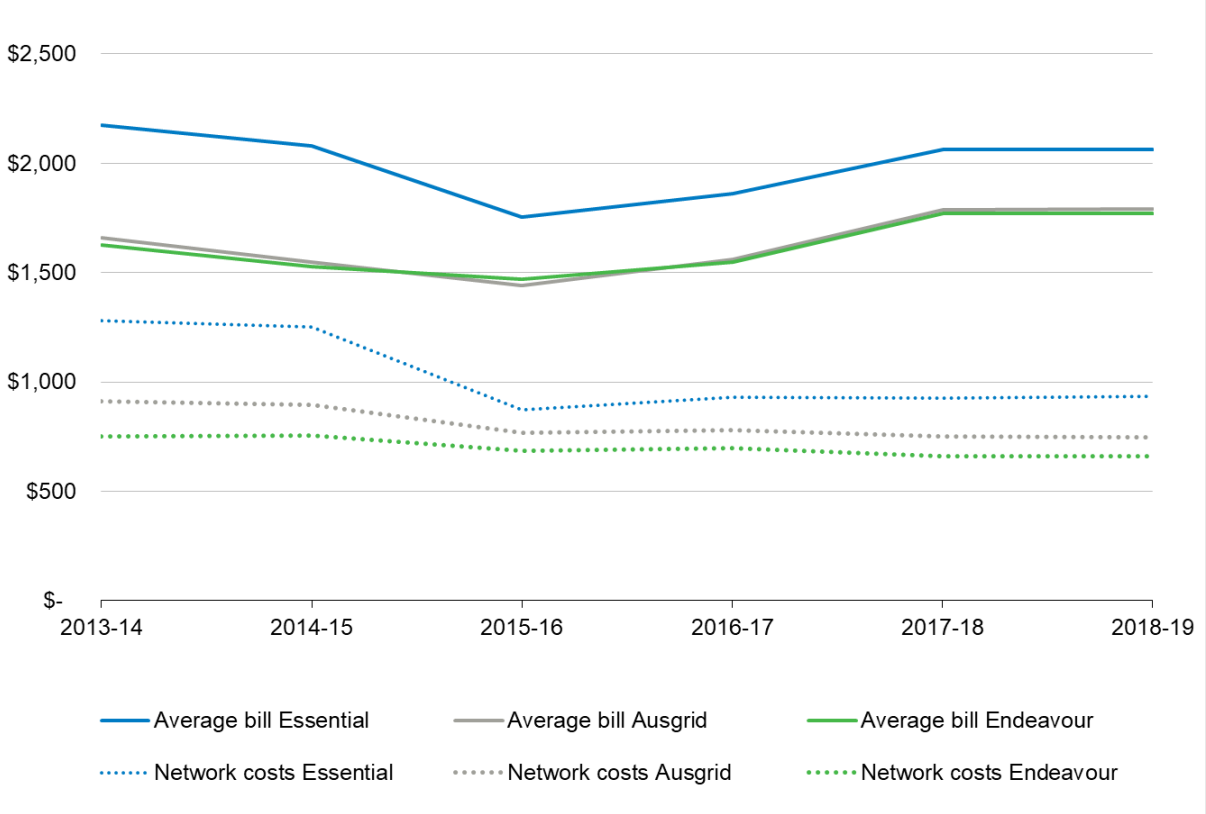
Source: Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW.*

1.4 Average electricity bills have fallen slightly in real terms since price deregulation in July 2014

Compared to the last year that prices were regulated in 2013-14, the average electricity bill has increased by around 8.5% in nominal terms in the Ausgrid and Endeavour network areas. This represents a 0.5% reduction in the average bill, when inflation is taken into account. In the Essential network area, the average bill has fallen by 5.2% in nominal terms in this period, which is a 13.0% reduction in real terms.

As Figure 1.1 shows, in the Essential network area this average bill reduction was driven by large reductions in network costs in 2015-16. This has also led to a reduction in the difference between regional and metropolitan average bills 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 and network costs since price deregulation (5,100 kWh pa, nominal, GST-inclusive)



Note: In previous years, we have calculated electricity bills 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. Network costs include network metering charges.

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

Across the three networks, network costs (which make up around 40% of the average residential customer's bill) have fallen by an average of 20% since 2013-14.[9] However, this large cost decrease has been mostly offset by a similarly large wholesale cost increase in 2016 and 2017. This wholesale cost increase was largely driven by rising gas costs, and a reduction in wholesale electricity supply following the closure of Hazelwood power station.

The ACCC found that retail margins in NSW have also increased since price deregulation, while retail costs have fallen. It found that retail margins have averaged 10% over the three years to 2017-18,[10] which compares to the regulated retail margin allowance of 5.7% set by IPART for 2013-14 in the final year that we regulated prices.[11]

Higher margins are consistent with the higher risks that energy retailers face due to the uncertainty about the regulatory and investment environment. Therefore, they do not suggest there is necessarily a problem with competition.

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

10 IPART calculations based on ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 37.

11 IPART, *Review of regulated retail prices for electricity*, June 2013, p 89.

Given this, we consider the most effective way of limiting further energy price increases in the future is to provide a stable and predictable regulatory and investment environment to encourage new investment to increase supply and replace existing generation assets reaching the end of their lives.

In relation to network costs, while these costs are expected to continue to fall in real terms in the coming years, more can be done to keep network prices as low as possible in the future. In particular, over-investment in electricity distribution networks was the main cause of the substantial increases in electricity bills in NSW over the period 2007-08 and 2013-14. To avoid similar over-investment in the future, governments should set distribution reliability standards using an economic framework that balances the cost of reliability with the value that customers place on it.

In addition, all new meters that are installed will be smart meters, which allow networks and retailers to charge more cost-reflective prices – for example, higher prices in times of higher demand, and lower prices when demand is low. This would provide incentives for customers to reduce their usage in peak periods, which in turn would mean that over the long term less investment is required in the networks to meet peak demand, putting downward pressure on prices.

1.5 Bills for metro customers on standing offers have increased in real terms since price deregulation

While average electricity bills have not increased in real terms since price deregulation, outcomes for individual customers depend on their level of engagement in the market. For example, customers who have not actively engaged in the market at their current address are supplied on a 'standing' offer, which is a default price for these customers, and is typically the highest on the market.

In this review, we found that 17% of customers were on standing offers in July 2018. In addition, at least 15% of customers who were on 'market offers' were paying 'standing offer' prices because they have not switched offers in the last few years.[12] Since price deregulation, average prices for those on standing offers have:

- Increased by 6% and 7% in real terms in the Ausgrid and Endeavour regions (or by 15% and 17% in nominal terms)
- Remained flat in nominal terms in the Essential region (or decreased by 9% in real terms).

On average, customers on **standing offers** with the big three retailers are paying around 26% more than the customers paying their **lowest available prices**.[13]

The difference between highest and lowest prices on the market does not suggest there is a problem with competition. In most competitive markets, customers will pay more or less for the same or similar goods depending on how willing they are to seek out the lowest prices.

12 IPART calculations, based on AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 62.

13 We note that AGL has recently announced that it will be giving a 10% discount to its standing offer customers commencing 1 January 2019. AGL, *AGL announces safety net for electricity customers*, https://www.agl.com.au/about-agl/media-centre/asx-and-media-releases/2018/november/agl-announces-safety-net-for-electricity-customers, accessed 22 November 2018.

Charging higher prices to customers who are less price sensitive allows businesses to recover more of their costs from these customers. This provides a benefit to price-sensitive customers, because retailers are then able to offer them lower prices.

A difference in the energy markets is that customers reconsider their purchasing decisions infrequently. Unlike buying other goods and services, where customers consider price before they purchase each individual item or unit, electricity customers only typically receive bills four times a year – after they have used the service. Many customers are on direct debit plans which makes them even less likely to be engaged in their purchasing decisions.

In addition, some customers face difficulties in shopping around or assessing which offer is best, even when they do actively reassess the prices they are paying. The AEMC reported that survey findings indicate customers felt less confident in their ability to choose the right offer for their circumstances in 2017-18 compared to previous years. And unlike other markets where participation is discretionary, most customers cannot opt out of purchasing electricity. This means that vulnerable customers might face particular difficulties, and also be unable to materially reduce electricity usage due to medical or family circumstances.[14]

For these reasons, retailers and governments have a role in making sure that vulnerable customers are able to engage in the market, and are prompted to do so regularly.

1.6 Governments and regulators are implementing wide-ranging measures to help customers engage in the market

In considering whether further government or regulatory action is necessary to make it easy for vulnerable customers to engage in the retail market, we examined the measures currently being implemented. Since the start of the transition to competitive markets, and particularly in the period after the large increase in electricity prices in July 2017, governments have focused on measures to help make it easier for customers to compare offers.

A key initiative of the NSW Government is the free 'Energy Switch' tool, which was launched in November 2018. Taking into account a customer's existing offer, it identifies whether there are cheaper offers available for that customer, how much they would save, and provides an option to initiate a change of retailer. It is offered both online and at ServiceNSW centres.[15]

The information used by Energy Switch comes from the Australian Government's Energy Made Easy website, which compares all retailers' generally available electricity and gas offers by calculating annual bills on a consistent basis. The Australian Energy Regulator (AER) (the body that provides the service on behalf of the Australian Government) 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)

14 PIAC submission to IPART Draft Report, 14 November 2017, p 3, 5-6.

15 NSW Government, *'Energy Switch to save households hundreds of dollars*, November 2018, https://www.nsw.gov.au/your-government/the-premier/media-releases-from-the-premier/energy-switch-to-save-nsw-households-hundreds-of-dollars/, accessed 28 November 2018.

and the ACCC have recently made recommendations to ensure that these websites deliver outcomes that are in the best interests of customers.[16]

In addition, a wide range of new measures are being implemented at both the state and national level. Many of these measures are designed to prompt customers to engage in the market more regularly.

1.6.1 New measures at the state level

From January 2018, the New South Wales Government introduced new obligations to help low-income and rebate 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
- 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.[17]

Following this change, a substantial proportion of customers switched from higher 'standing offers' to lower market offers.

1.6.2 New measures at the national level

At the national level, several new requirements on retailers have recently been introduced to make it easier for consumers to engage in the market and compare offers, and prompt them to stay engaged in the market rather than 'set and forget':

- From August 2018, the AER's Retail Pricing Information Guidelines (RPIG)[18] requires retailers to include in its offer information an annual bill comparison table for different consumption levels on a consistent basis. This enables customers to compare offers without having to make any calculations.[19]
- From August 2018, a rule change by the AEMC came into effect, requiring retailers to notify customers when the discount included in their market offer will end.[20]
- From February 2019, a further rule change will require retailers to notify their customers of any price changes in advance. [21] (Currently they are not required to notify customers of prices changes until after they have taken place, and often these notifications are not obvious.)

16 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 84; ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 282.
17 *NSW Social Programs for Energy Code*, December 2017.
18 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.
19 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, pp 108-109.
20 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.
21 AEMC, *Advance notice of price changes,* https://www.aemc.gov.au/rule-changes/advance-notice-price-changes, accessed 27 September 2018.

- The AEMC has also received a rule change that would require retailers to write to their standing offer customers every 12 months, to inform them that there are cheaper offers in the market.[22] Following several roundtable meetings with the Prime Minister in August 2017, many retailers started doing this voluntarily last year.[23]

1.7 A regulated "default offer" is likely to lead to higher prices in longer term

The Australian Government has announced further intervention in retail energy markets with the aim of reducing customer bills. It has asked the AER to develop by 30 April 2019:

- A mechanism for determining a reference bill amount for each network distribution region, from which headline discounts can be calculated
- Maximum prices for standing offers by replacing them with a default offer, which would apply from 1 July 2019 for customers not subject to state-based price regulation.[24]

The introduction of a non-binding reference bill amount (or 'benchmark tariff') could assist customers to assess the value of different offers, by making advertised discounts comparable across retailers, while minimising the additional risks for retailers.

However, we consider that a regulated maximum 'default offer' is likely to lead to higher prices in the long run by reducing the levels of competition. In the short term, a default offer 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. Because the default offer would have government oversight, some customers would be less likely to engage in the market because they believe that they are paying a 'fair' price for energy, even though they would have otherwise switched onto a cheaper market offer. In turn, this smaller market for 'active' customers would lead to less vigorous competition and innovation, with fewer retailers competing in this market (Figure 1.2).

Figure 1.2 Impact of a price regulation (or a 'default offer')

In addition, both the default offer and benchmark tariffs would be set based on the consumption of the average consumer. This encourages retailers to continue structuring

22 AEMC, *Long term standing offer notice*, https://www.aemc.gov.au/rule-changes/long-term-standing-offer-notice, accessed 27 September 2018.
23 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 50.
24 AER, Retail electricity prices review - Determination of default market offer prices, https://www.aer.gov.au/retail-markets/retail-guidelines-reviews/retail-electricity-prices-review-determination-of-default-market-offer-prices, accessed 20 November 2018.

offers around the average customer's needs, so innovative tariff offers would be less likely to emerge, and customers with different patterns of consumption would be worse off.

It is important to recognise that the default offer would need to be set at a level that would enable retailers to recover their costs of supply, to ensure they remain financially viable. Therefore, the default offer – or any form of price regulation – would not prevent prices from increasing if the underlying costs of supply were increasing.

To illustrate this point, the largest electricity price increases that occurred in NSW over a sustained period were between 2007-08 and 2013-14 – when prices more than doubled, driven by large increases in network costs.[25] During this period, retail electricity prices were regulated. While customers had the option to choose a competitive market offer, they could also remain on a standard form contract with a regulated price – in an arrangement very similar to the one the Australian Government proposes.

1.8 Structure of this report

The rest of this report discusses our review, findings and analysis in more detail:

- Chapter 2 outlines the context for our review, including our terms of reference and review process
- Chapters 3 to 5 focus on our review and findings on the performance and competitiveness of the NSW retail energy markets in 2017-18
- Chapters 6 and 7 discuss our review of electricity price changes over time and into 2018-19
- Chapter 8 discuss our review of gas price changes into 2018-19
- Chapter 9 focuses on measures to enhance competition and customer outcomes.

1.9 List of recommendations and findings

Recommendation

1 The NSW Government submit a new transitional rule change to the AEMC to prohibit retailers from engaging in retention and win-back activities for six months following a switch. The proposed rule should be in place for a fixed transitional period (for example, three years) while competition continues to develop. 98

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

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:

- increasing costs of effectively managing their wholesale price risk
- aggressive retention and win-back activity of incumbent retailers
- inconsistent jurisdictional regulations
- increased regulatory and political intervention in the energy market. 33

2 There are no substantial barriers to setting up a retail business in the NSW gas market. However, difficulty in securing gas pipeline and network agreements and high wholesale costs may increase the economic barriers, which means that a new retailer needs considerable financial capacity to gain market share. 39

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. 54

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 10% for 2018-19. This is mainly due to substantial reductions in forward wholesale prices of around 35% in 2018-19 (average forward prices in June 2017, compared to June 2018). 73

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. 74

6 A detailed review of electricity retail prices and margins is not necessary as the ACCC has recently completed its Retail Electricity Pricing Inquiry. 74

7 The average electricity bill increase for residential customers in metropolitan areas since price deregulation is 8.5%. This is a real decrease in prices of 0.5 % (once CPI is accounted for). 78

8 The average electricity bill decrease for residential customers in regional areas since price deregulation is 5.2%. This is a real decrease in prices of 13.0% (once CPI is accounted for). 78

9 Since price deregulation, the bill for a typical Ausgrid small business customer has increased by 1.1% in nominal terms, and decreased by 6.8% and 17.9% 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. 79

11 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 customers and increased by 1.7% 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. 90

12 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. 90

13 The 'big three' electricity retailers have a particular financial advantage over new entrants that enables them to offer very cheap win-back or retention offers to their customers who decide to switch retailers. As a result they have little incentive to give their long-standing customers a better price or service. 98

2 Context and approach

This is the fourth annual report on the performance and competitiveness of the retail electricity market in NSW in our role as the state's market monitor since retail electricity prices were deregulated in July 2014. It is our first annual report on the retail gas market since retail gas prices were deregulated in July 2017. In addition, it reports on two special reviews that the Minister for Energy and Utilities (the Minister) asked us to complete as part of our market monitoring role.

The sections below explain this role and the two special reviews. The subsequent sections outline our process for performing this role, other regulators' monitoring roles, and 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.[26] After more than 10 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.[27] 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).[28]

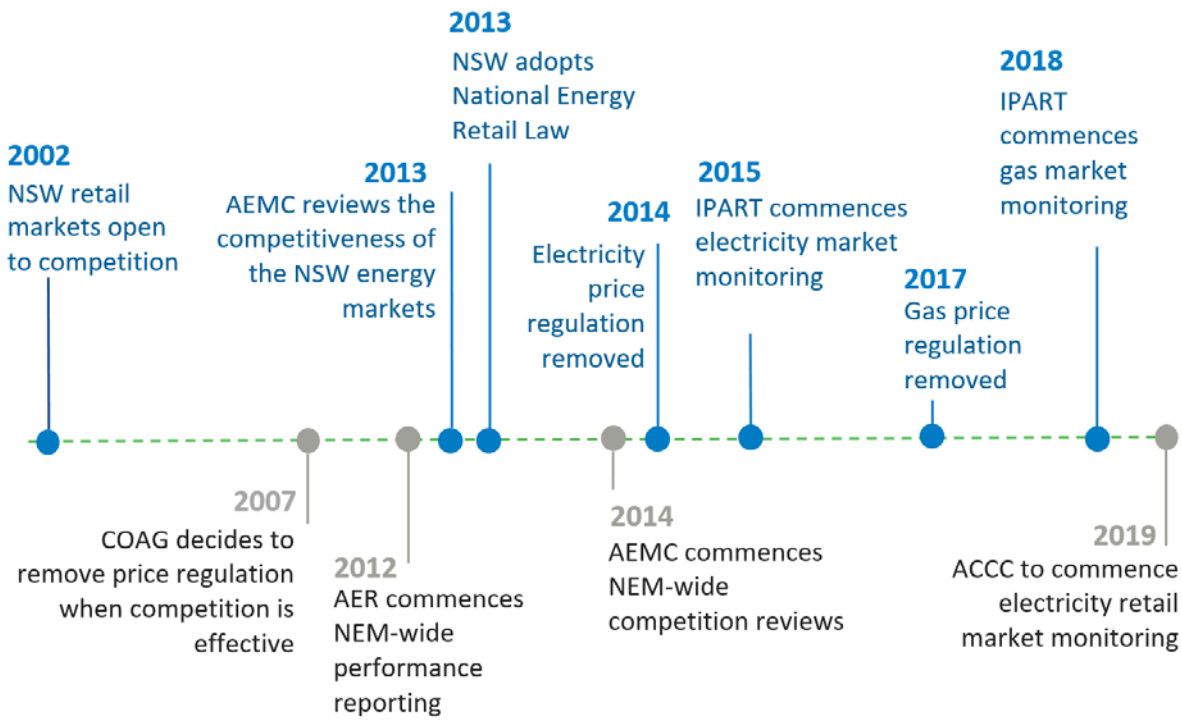
A number of other regulators also review the energy retail markets (discussed further in section 2.2 below).

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

27 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.

28 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).[29] 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. We must consider these factors in combination – no single factor is conclusive in determining whether competition is effective. These factors, and where to find our analysis of them in this report, are set out in Table 2.1.[30]

Table 2.1 Factors we are required to consider in determining whether competition is effective

Factor	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, 9
Any barriers to entry 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 4,6,8

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

29 *Ibid.*
30 *Ibid.*

The Act also specifies that we must consider whether there are any actions needed to improve the competitiveness of the market, if we are of the opinion that it is required (discussed in Chapter 9).[31] We must also report on whether a detailed review of retail prices and profit margins in each market is required (discussed in Chapters 6 and 8).[32] Further, in considering the performance of the market, we are required to consider prices of electricity and gas for small customers in regional areas (discussed in Chapters 7 and 8).[33] Finally, the Act allows us to report on any other relevant matters in reviewing the competitiveness and performance of the market.[34]

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
- 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.[35]

We note that information from the AER that has been relied upon throughout this report might be have been affected by data errors relating to AGL customers, and may be updated in the future.[36] We have reported this information where it is the best currently available data source.

31 Section 234A(3)(f) of the *National Energy Retail Law (NSW).*
32 Section 234A(3)(g) of the *National Energy Retail Law (NSW).*
33 Section 234A(3)(b) of the *National Energy Retail Law (NSW).*
34 Section 234A(3)(h) of the *National Energy Retail Law (NSW).*
35 Section 234A(7),(8) of the *National Energy Retail Law (NSW).*
36 AGL advised the AER of significant errors with the information it has provided impacting on many reporting metrics over the financial year 2017-18. Given AGL's share of the retail market and the impact such errors have on aggregate results, the AER removed all retail performance data from its website. It is currently examining the implications of AGL's failure to submit accurate and timely information, and expects to correct data issues by December 2018. AER, *Retail Statistics*, https://www.aer.gov.au/retail-markets/retail-statistics, accessed 21 November 2018.

2.2 Special reviews conducted as part of this role

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.[37]

This year, 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. In particular, we were asked to assess whether these changes reflect efficient costs in a competitive market. In addition, the Minister asked to consider any relevant issues that are raised in the Australian Competition and Consumer Commission's (ACCC) Retail Electricity Pricing Inquiry: Final Report (see Appendix B). The ACCC was asked to conduct a one-off wide-ranging inquiry into electricity supply and prices that was finalised in July 2018.

As part of this inquiry, the ACCC considered changes in prices and costs up until 2017-18. To allow us to consider price changes since July 2018, we engaged ACIL Allen to review any changes in costs of supplying electricity that occurred after the ACCC's review was completed. We also engaged Oakley Greenwood to examine the change in costs for the gas market in 2018-19. 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 also examined some of the analysis and recommendations in the ACCC's Final Report, to assess their relevance to the NSW markets (Chapter 9).

2.3 Our process for this review

In May 2018, we began our review process by releasing an Information Paper that outlined our proposed approach for the review and inviting stakeholder comment (Figure 2.2). We received nine submissions (Table 2.2). We also released a Draft Report at the beginning of October, and received 10 submissions. We have considered all comments from stakeholders in making our findings for this report.

Figure 2.2 Timetable for review

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

Table 2.2 Submissions received over the course of the review

Stakeholder	Information Paper	Draft Report
Australian Energy Council	√	√
Public Interest and Advocacy Centre	√	√
AGL		√
Origin	√	√
EnergyAustralia	√	
Sumo		√
Lumo Energy	√	
Simply Energy	√	
Ausgrid		√
Individuals	3	4
Sum	**9**	**10**

2.4 Other regulators' monitoring roles

As noted above, a number of other regulators also review the retail electricity market. These regulators, and the recent reviews they have undertaken are listed in Table 2.3. Their monitoring roles are outlined in more detail below.

Table 2.3 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.[38] 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 Energy Consumers Australia in relation to residential customers.[39]

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.[40] If the AEMC found effective competition it would provide advice on ways to phase out retail price regulation.[41] It completed its review of the NSW market in 2013,[42] and price regulation was removed in NSW on 1 July 2014.

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.[43]

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
- Energy affordability, including estimates of the annual bills of households, and bills as a proportion of household disposable income.[44]

38 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.
39 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 2.
40 AEMC, 2014 Retail Competition Review, https://www.aemc.gov.au/markets-reviews-advice/2014-retail-competition-review, accessed 25 September 2018.
41 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.
42 AEMC, *Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales*, October 2013.
43 AEMC, *Possible Future Retail Electricity Price Movements: 1 July 2011 to 30 June 2014*, November 2011.
44 AER, *Annual report on the performance of the retail energy market 2012-13*, Revised February 2014, pp 2-3.

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. Under this regime, monitoring would be undertaken by the AER and supported by powers to compulsorily obtain information from retailers, including full EBITDA data.[45]

The ACCC has now been given this ongoing monitoring role. It is required to report every six months commencing March 2019.[46] 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 is 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.[47]

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 market for gas, it will also be reviewing retailer pricing, cost and margins over the course of the inquiry.[48]

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.[49] 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.[50]
- **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 businesses have been privatised.[51]

45 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p xxiii.
46 ACCC, *Electricity market monitoring 2018-2025*, https://www.accc.gov.au/regulated-infrastructure/energy/electricity-market-monitoring-2018-2025, accessed 25 September 2018.
47 *Ibid*.
48 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.
49 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p iv.
50 *Ibid*, p xvii.
51 *Ibid*, p x.

- **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 retailers to reference their discounted market offers to the default offer.[52]

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.[53]

In particular, it found that energy prices were increasing, and the majority of consumers no longer believe that the market is 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.[54]

52 *Ibid*, p xiii.
53 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.
54 *Ibid*, pp ii, vi, xvi.

3 No substantial 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 and submissions to our Draft Report. The sections below outline our findings, then discuss them in more detail.

3.1 Overview of findings

As at September 2018, there were 24 retailers (and 29 brands) operating in the electricity market.[55] Both the continued entry of new retailers, and the large number of smaller 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 smaller retailers to grow their customer base.

The ACCC 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.[56] The ACCC also found that aggressive retention strategies of the big three retailers are likely to be slowing the expansion of the smaller retailers.

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.[57] However, difficulties in securing gas transportation agreements and high gas wholesale prices may be deterring further entry.

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

55 .
56 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 150.
57 AEMC, *2018 Retail energy competition review*, Final Report, 15 June 2018, pp 43.

active gas retailer. However, even where there is only one gas retailer, gas prices are constrained by both the threat of entry from new retailers and the availability of 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, which poses some constraints on gas price increases.

3.2 Large number of retailers contesting 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.[58] 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 September 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 Business 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.

Nine of the electricity retail businesses also offered gas retail services (under 12 brands).[59] This is discussed further in the sections below.

58 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.

59 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

		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		
	ActewAGL	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	Ausgrid, Endeavour 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 and Red Energy are subsidiaries of Snowy Hydro. Lumo is no longer offering electricity to new customers.

Source: Energy Made Easy.

3.3 Retail electricity 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 residential and small business customers:

- AGL had 23%
- EnergyAustralia had 28%
- Origin Energy had 33%.[60]

While the combined market share of the 21 smaller retailers only sits at 15%, it has more than tripled from 4% since 2013, in the last year that prices were regulated in NSW.[61] We expect that it would take some time for a small retailer to build a substantial market share.

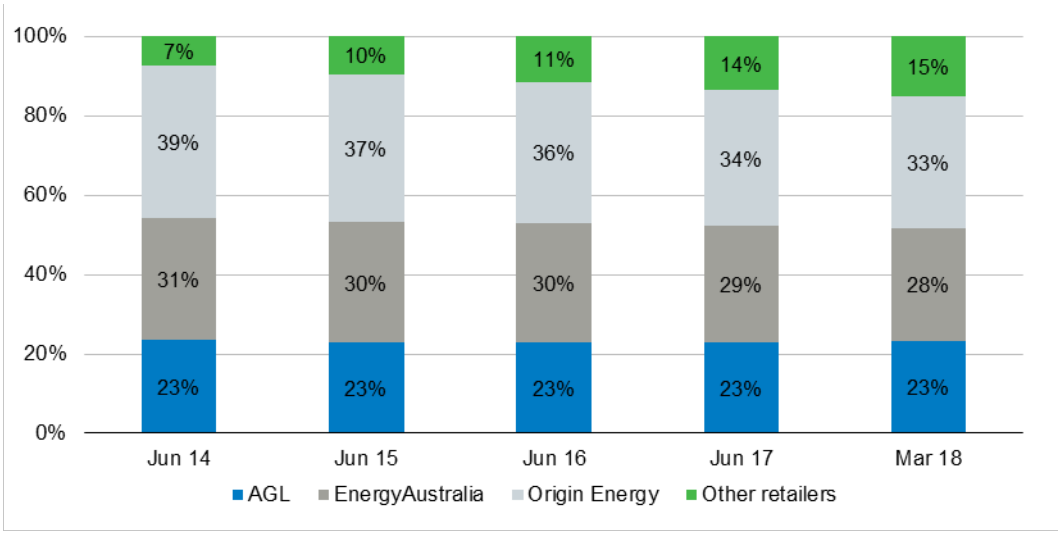
Snowy Hydro, under its Red Energy brand, has the highest market share of the smaller retailers. As at June 2017, it had around 45% of customers who were not supplied by one of the big three (Figure 3.2), or around 5% of the market overall.[62] One of the reasons why Red Energy might have been able to expand its market share relatively successfully is that it also owns wholesale assets, which provide it with a natural hedge.

60 Numbers may not add due to rounding. AER retail statistics https://www.aer.gov.au/retail-markets/retail-statistics/nsw-small-customers, accessed 10 September 2018. We note that this information may have some data errors relating to AGL customers and may be updated in the future. However we have reported this information because it is remains the best available data source.

61 *Ibid;* AEMC, *2018 Retail energy competition review, Final Report,* 15 June 2018, p 274.

62 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.

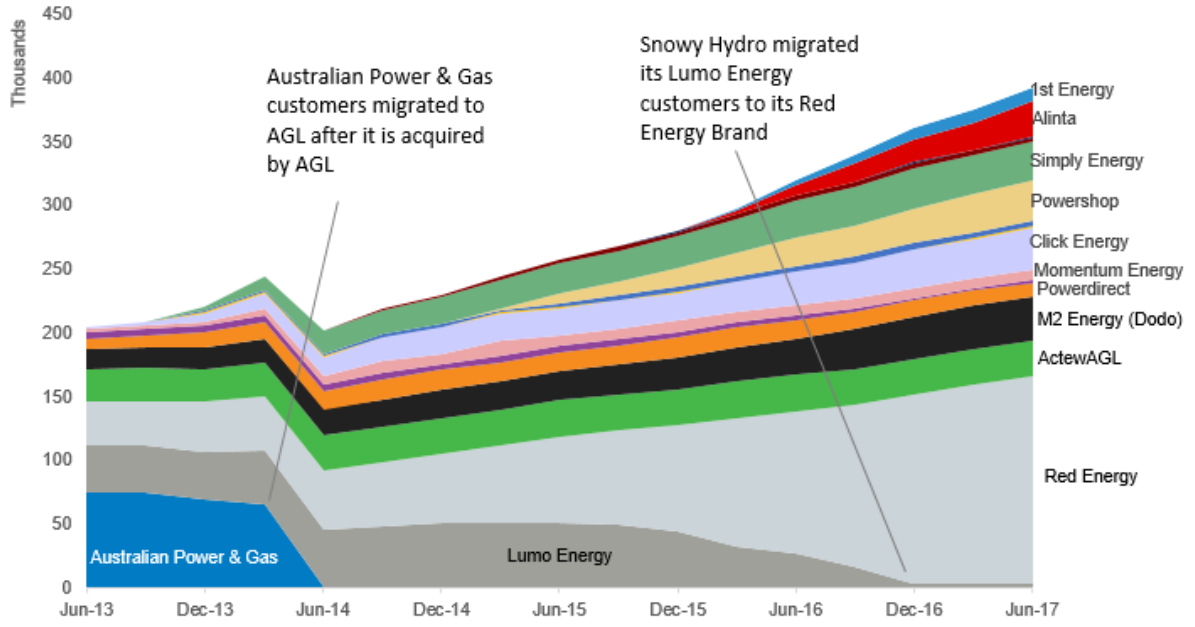
Figure 3.1 Change in electricity retailers' market share for all small customers



Note: Numbers may not add due to rounding.

Data source: AER retail statistics https://www.aer.gov.au/retail-markets/retail-statistics/nsw-small-customers, accessed 10 September 2018. We note that this information may have some data errors relating to AGL customers and may be updated in the future. However we have reported this information because it is remains the best available data source.

Figure 3.2 Change in residential and business customer numbers for smaller retailers to June 2017



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

PIAC submitted that the level of market concentration (with the big three retailers serving 85% of the market) is too high.[63] 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

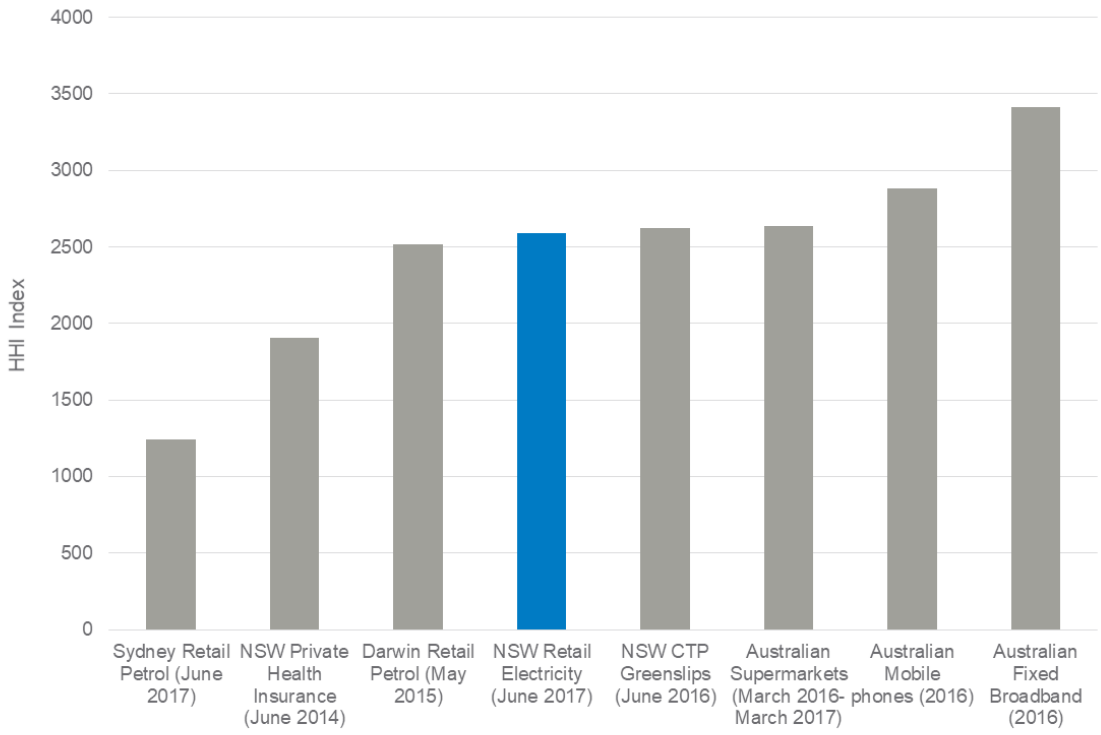
services being provided in competitive markets that are not price regulated. These include groceries, private health insurance, telecommunications services, and NSW compulsory third party (CTP) Greenslips (Box 3.1). PIAC noted that the ACCC has raised concerns about the levels in these industries as well (such as petrol, broadband and mobile), and suggested that this is of even greater concern for energy because it is an essential service.[64]

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 by industry (Australia)



Source: Based on 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).

63 PIAC submission to Draft Report, November 2018, p 3.
64 *Ibid.*

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 smaller 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.[65]

However, other findings indicate that:

- Reduced contract market liquidity is making it harder for smaller retailers to effectively manage their wholesale price risk[66]
- Aggressive customer retention practices by the large retailers are impeding the smaller retailers expanding their customer bases[67]
- Inconsistent jurisdictional regulations are likely to be increasing costs for all retailers, and the per customer costs are likely to be increasing by more for smaller retailers, because they have to spread these costs across a lower number of customers[68]
- Political and regulatory intervention is also increasing risks and costs for retailers.[69]

Reduced contract market liquidity making it harder for smaller retailers to manage wholesale price risk

Effective and efficient hedging markets are a crucial tool for all types of retailers.[70] 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.[71]

In response to our Draft Report, Sumo submitted that hedging costs were higher for smaller retailers for three reasons:

- **Lower availability of load-following hedges.** Sumo submitted that it is more economic for smaller retailers to manage their wholesale risk through low-risk load-following hedging contracts, rather than a portfolio of different products, because they have a smaller number of customers which results in higher demand volatility.[72] As coal-fired generators exit the market[73] and are replaced by non-dispatchable wind and solar generation, the availability of these 'firm' or load-following hedging contracts is

65 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 149.
66 *Ibid*, p 131.
67 *Ibid*, p 151.
68 *Ibid*, p 321.
69 *Ibid*, p 226.
70 *Ibid,* p 150.
71 *Ibid*.
72 Sumo submitted that larger retailers will typically build a portfolio of wholesale hedging products, comprising swaps, caps, offtake agreements, but it is uneconomic for a small retailer to adopt this strategy until it has approximately 100,000 residential customers (or equivalent). Sumo submission to IPART Draft Report, November 2018, p 2.
73 Including Northern Power Station in South Australia, and Hazelwood Power Station in Victoria.

declining.[74] The availability of low-risk over-the-counter hedging contracts has also declined because in a high-price market, generators are able to meet their targets without taking on the additional risk associated with offering such products. Sumo submitted that fewer NSW generators are offering load-following hedges, and they are less inclined to offer customised products compared to Victoria.

- **Cheaper long term off-take agreements are less suitable for smaller retailers.** Smaller retailers do not have the capacity or the level of future certainty to hedge as far forward as larger retailers, which can limit options for entering into long-term offtake agreements (eg for ten years) being offered by new generators with non-dispatchable power.
- **Increasing prudential costs.** Increased wholesale price volatility is resulting in increased demands for prudential support from wholesale counterparties and from AEMO, which is further exacerbating the costs for smaller retailers.[75]

The ACCC found that while smaller retailers are currently able to access exchange-traded derivative products to hedge their risk exposure, the combination of vertical integration and concentration in the NEM has reduced contract market liquidity[76] and is making it harder for all parties to effectively manage their wholesale price risk. These findings support Sumo's submission that there are now very few suppliers of load-following hedges. The ACCC also found that the cost of access to the ASX has increased and as a result smaller retailers may find it harder to enter and expand.[77]

To address these issues, Sumo's submission supported measures that will lead to:

- Increased generation capacity – particularly from non-vertically integrated new entrants, and particularly reliable, dispatchable generation that will also support a liquid hedging market
- Constraints on further consolidation of ownership of generation assets
- More effective ring-fencing of the retail and generation divisions of a 'gentailer'.[78]

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.[79]

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 (typically during a specified time window each day). It also noted that should the market

74 Long-term offtake arrangements with non-dispatchable generators do not necessarily guarantee supply, and so they must be complemented with other hedging products

75 Sumo submission to IPART Draft Report, November 2018, pp 2-3.

76 AGL submitted that liquidity has remained constant since 2006-07. It states that the liquidity ratio, calculated as total Sydney Futures Exchange and OTC volumes divided by NEM demand, has generally been around or greater than 3 times NEM demand since 2006/07, even though the three big retailers have increased their share of installed capacity from almost nothing in 2004 to around 49% in 2015. However it agreed that the availability of load-following hedges is declining. AGL submission to IPART Draft Report, November 2018, pp 1-2.

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

78 Sumo submission to IPART Draft Report, November 2018, p 3.

79 *Ibid.*

making obligation prove to be highly effective in South Australia it may be expanded to include other NEM regions if liquidity concerns are identified.[80]

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 smaller 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.[81]

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.[82]

Aggressive customer retention practices by large retailers impeding expansion of smaller retailers

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 and win-back practices of the large retailers.

Where a customer arranges to switch retailers, it is common for their previous retailer (the 'losing' retailer) to offer very cheap retention and win-back 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 practices.

The big three retailers can offer lower retention or win-back prices to customers planning to switch, because they have a larger and 'stickier' customer base from which to recover their fixed and sunk costs. One of the reasons these customers are stickier is because unlike the smaller retailers, they purchased a large proportion of their customers from government retailers, rather than 'winning' them. These customers are less likely to engage in the market in the future, because they have not engaged in the market previously. This means these customers can be charged higher prices, with less risk of losing them.

In response to feedback from Sumo and PIAC to our Draft Report, we conducted further analysis on whether the retention and win-back activity is in the long-term interests of consumers. Our findings are discussed in Chapter 9 of this report where we consider whether new measures are required to improve customer outcomes.

80 *Ibid.*
81 *Ibid*, p 112.
82 *Ibid*, p 122.

Inconsistent jurisdictional regulations increasing 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.[83]

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.[84] 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.[85] 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.[86]

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 increasing risk and costs

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.[87]

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 to the AEMC that the cost to service customers resulting from regulatory intervention is increasing more than the cost to acquire customers.[88]

83 Simply Energy submission to IPART Information Paper, August 2018, p 1.
84 AEMC, *2018 Retail energy competition review*, Final Report, 15 June 2018, p 268.
85 Simply Energy submission to IPART Information Paper, August 2018, p 2.
86 AEMC, *2018 Retail energy competition review*, Final Report, 15 June 2018, p 40.
87 *Ibid*, p 30.
88 The AEMC noted that it does not have access to data to verify the level of this increase. *Ibid.*

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:

- increasing costs of effectively managing their wholesale price risk
- aggressive retention and win-back activity of incumbent retailers
- inconsistent jurisdictional regulations
- increased regulatory and political intervention in the energy market.

3.4 Increasing number of retailers active in gas markets

As noted above, nine of the 24 electricity retailers active in NSW also provide gas retail services in NSW (under 12 brands). This is up from 4 gas retailers (under 5 brands) in 2013.[89]

Three of these retailers have entered the market following price deregulation in July 2017: Simply Energy, Alinta, and Amaysim.[90] 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).

While all the gas retailers are also active in the electricity retail market, only one – Simply Energy – 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 NSW 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 (Figure 3.3).[91] At the end of 2013, smaller retailers did not supply any of the market for small customers. By March 2018, the market share of smaller retailers was about 7%.[92]

As at the end of March 2018, the big three retailers had around 93% share of the NSW gas market for residential and small business customers:

- AGL had 47%
- EnergyAustralia had 25%
- Origin Energy had 21%.[93]

89 AEMC, *2018 Retail energy competition review,* Final Report, 15 June 2018, pp 268, 274.

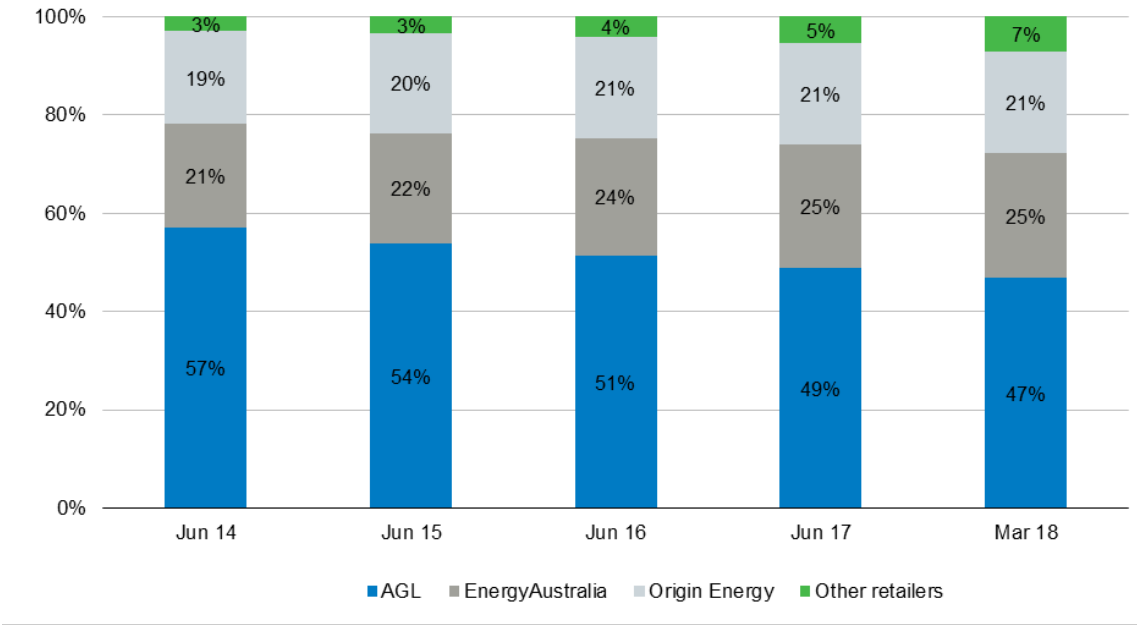
90 *Ibid*, p 43.

91 The Herfindahl-Hirschman Index (HIH) for the NSW gas market 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, 274.

92 *Ibid.*

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

Figure 3.3 Change in gas retailers' market share for all small customers (2014 to 2018)



Data source: AER, *Retail performance statistics*, https://www.aer.gov.au/retail-markets/retail-statistics/nsw-small-customers, accessed 10 September 2018. We note that this information may have data errors relating to AGL customers and may be updated in the future. However we have reported this information because it is remains the best available data source.

3.5 Number of active gas retailers varies by network area

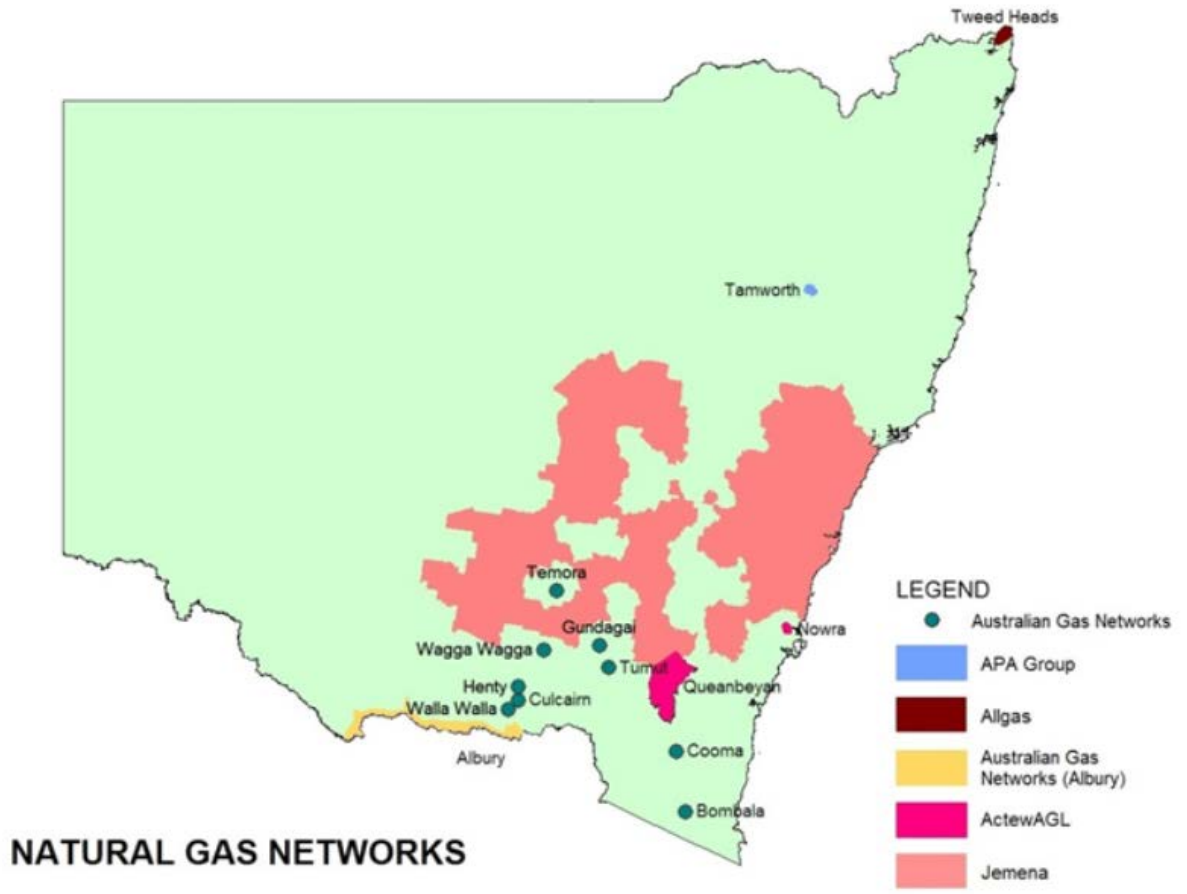
While the number of gas retailers continues to grow across NSW and the level of concentration is falling, there are variations across distribution networks across NSW (Figure 3.4), as not all of the retailers are active in each of these (Table 3.2).

Of the 1.4 million[94] gas customers in NSW, 1.3 million are located in the Jemena network, which covers 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.[95] All gas retailers active in the Jemena network except for ActewAGL supply residential customers, and all but Alinta and Dodo supply business customers.

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

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

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.

Outside of the Jemena network, only Origin, AGL, EnergyAustralia, Red Energy, and ActewAGL are active in the gas market. Up to three of these retailers are active in any of the 10 smaller networks. 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.[96]

96 Energy Made Easy.

Table 3.2 Gas retailers in NSW by network area

	Retailer	Jemena	Wagga Wagga	Albury	Murray Valley	Tamworth	Shoal-haven	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.

3.6 Pipeline arrangements and high wholesale prices may be deterring further entry into the gas retail market

As noted above, there have been three new entrants to the Jemena region in the last year. In addition, Royal Dutch Shell may enter into the retail gas market as part of expanding its business beyond commercial and industrial customers.[97] However, two factors may be acting as economic barriers to new entrants:

- The difficulty in securing gas pipeline and network agreements
- High gas wholesale prices.

3.6.1 Difficulty in securing gas pipeline and network agreements may be barrier to new entrants

Because there is no NSW-based gas production, retailers must secure a gas transportation agreement for gas produced in Victoria (Gippsland) or from South Australia/Queensland (Cooper). In response to our Draft Report, Sumo submitted it is 'near impossible' for a capital-

97 AEMC, *2018 Retail energy competition review*, Final Report, 15 June 2018, p 43.

light retailer to secure an agreement. It noted these agreements are often long-term contracts without flexibility to mimic residential demand (load factor/seasonality). In addition, the need to negotiate access to pipelines contributes to higher fixed costs to enter the retail gas market relative to the retail electricity market.[98]

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.[99] For the period 2018 to 2020, public information reported by pipeline operators indicates that there is firm capacity available on:

- The South West Queensland Pipeline (Wallumbilla to Moomba) (27.4 to 194 TJ/d firm capacity reportedly available)
- The Moomba to Sydney Pipeline (Moomba to Wilton) (22.3 to 116 TJ/d firm capacity reportedly available).

However, for the Moomba to Adelaide Pipeline (Moomba to Adelaide), no firm capacity is available until 2020.[100]

These pipelines play a significant role in the market and access to compression capacity can act as a potential barrier to new market entrants.

In March 2014, a gas supply hub was established at Wallumbilla to improve market liquidity on the east coast by allowing trading participants across different pipelines to more easily trade with each other. Through an electronic platform, participants can trade standardised, short-term physical gas products at each of the three foundation pipelines connecting at Wallumbilla.[101] However, the APA reports that there is currently no firm compression (low to high pressure) (0 TJ/d out of a nameplate capacity of 737 TJ/d) available during the period between 2018 and 2020. Two major retailers and a major producer have contracted all of the firm compression capacity at Wallumbilla during this period.

A number of transportation related reforms are in the process of being implemented that are expected to improve the efficiency with which capacity is allocated and used on pipelines and compression facilities. The reforms include a capacity trading platform and day-ahead auction which have been approved by the COAG Energy Council and are intended to commence on 1 March 2019.[102] They would allow the contracted but un-nominated compression capacity to be released to the market to enable other market participants, particularly new entrants, to transport gas to the Southern States.[103] These reforms should enable market participants to gain access to more competitively priced secondary transportation capacity. For example, the ACCC reported that between 1 May 2017 and 30 April 2018, at least one shipper had at least around 36 TJ/d of unutilised capacity on the Wallumbilla pipeline even during its peak usage periods during the period. It did not use

98 Sumo submission to IPART Draft Report, November 2018, p 3.
99 IPART, *Review of regulated retail prices and charges for gas from 1 July 2016*, June 2016, p 22.
100 ACCC Gas Inquiry 2017-2020, Interim Report July 2018, p 35.
101 AEMO, *Gas Supply Hubs*, https://www.aemo.com.au/Gas/Gas-Supply-Hubs, accessed 21 November 2018.
102 ACCC Gas Inquiry 2017-2020, Interim report July 2018, p 20.
103 ACCC Gas Inquiry 2017-2020, Interim Report July 2020, p 37.

any of its firm capacity for around six months. However, there were no requests from any shippers for the unutilised capacity to be made available.

Going forward, the firm compression services at Wallumbilla are proposed to be sold on the capacity trading platform and be subject to the day-ahead auction from 1 March 2019. This should create incentives for primary capacity holders to sell spare capacity and can allow prospective shippers the opportunity to purchase competitively priced capacity.

Releasing spare firm capacity to another market participant can result in more competition and more choices for customers, particularly in regional areas where there generally is only one gas pipeline option. The ACCC Gas Inquiry 2017-2020 will continue to monitor secondary capacity trading, particularly in the lead up to the implementation of day ahead auction and secondary capacity trading market reforms.[104]

3.6.2 High wholesale costs of gas may impact new entrants

In its 2018 Retail Energy Competition Review, the AEMC reported that as a result of high wholesale prices, many smaller electricity retailers said that they were not looking to expand into the gas market. Vertical integration is less common in the gas sector than for electricity (with only Origin and AGL having upstream assets) so access to competitively priced gas contracts is necessary.[105]

In response to the AEMC's survey:

- One retailer said that constrained gas supply was the main influence on competition over the next one to two years. It said that while more gas contracts have become available since the Australian Government announced it may restrict the export of gas to ensure domestic supply, there is a still a risk of not being able to get access to gas contracts in NSW.
- Another retailer commented that financial products are less prevalent in gas and therefore it is unable to manage its risk through financial or physical contracts. It 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.
- Multiple retailers said that it can take a long time to organise gas agreements.[106]

In April 2017, the Australian Government directed the ACCC to conduct a wide-ranging inquiry into the supply of and demand for wholesale gas in Australia, as well as to publish regular information on the supply and pricing of gas for the next three years. The ACCC was also requested to work with Dr Michael Vertigan to recommend longer term transparency measures.[107] The scope of this work will cover the full supply chain, including producers, transporters and retailers.

104 ACCC Gas Inquiry 2017-2020, Interim Report July 2018, p 38.
105 AEMC, *2018 Retail energy competition review,* Final Report, p 43-44.
106 AEMC, *2018 Retail energy competition review,* Final Report, June 2018 pp 46-48.
107 ACCC, *ACCC to investigate and report on Australian gas markets and market transparency*, https://www.accc.gov.au/media-release/accc-to-investigate-and-report-on-australian-gas-markets-and-market-transparency, accessed November 27 2018.

Finding

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

4 Retailers are competing to retain and attract 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 findings, and then discuss them in more detail.

4.1 Overview of findings

The evidence indicates that retailers competed to attract and retain customers in 2017-18. We found that they were primarily competing on price:

- 'All-day tariffs' were still most common offers, but other more cost-reflective price structures were also available
- There was a wide variation in price offerings for both gas and electricity
- Retailers continued to use price discounts compared to their standing offer rate as the main way to attract customers rather than tailoring their products to different customers based on their consumption profiles.

Retailers were also competing on products – for example, by bundling services, offering rewards such as frequent flyer points, and using solar feed-in tariffs to attract customers. Many retailers also marketed themselves as sustainable or 'green' energy providers to differentiate themselves.

We consider price variation is consistent with a competitive retail market, and supports innovation and dynamic efficiency.

4.2 All-day tariffs are the most common structure but more cost-reflective price structures are available

Most electricity customers (and all gas customers) are on offers that typically comprises a fixed daily supply charge and a consumption charge per kilowatt hour (kWh) (or kilojoule (KJ)) of energy consumed (an all-day tariff). This is because most customers still have accumulation meters, which can only measure the total amount of energy consumed over a time period.

Customers on all-day tariffs pay either one rate for all consumption over a period, or a higher or lower charge once a consumption threshold is reached (known as inclining or declining block tariffs). For example, an electricity offer in the Ausgrid network advertised on Energy Made Easy in July 2018 included:

- a daily supply charge of 84 c per day
- a consumption charge of 28.9 c/kWh for all usage
- a discount of 12% applied to the total bill.

An electricity offer with a declining block tariff structure included:

- a daily supply charge of 83 c per day
- consumption charges of 26.2 c/kWh for the first 10.96 kWh of electricity consumed per day, 25.9 c/kWh for the next 10.96 kWh consumed per day, and 25.7 c/kWh for the remainder consumed per day
- a discount of 10% was applicable to the total bill.[108]

However, other more cost-reflective price structures were also available to some customers. These include time-of-use tariffs and demand tariffs.

4.2.1 Time-of-use tariffs are available to around 16% of customers

Around 16% of customers in NSW have more sophisticated meters, which can measure the amount of electricity consumed in every half hour. The majority of these are located in the Ausgrid region.[109] This allows them to be charged different rates depending on the **time** that electricity is consumed – usually by peak, shoulder and off-peak times. These offers are known as time-of-use (TOU) offers. They are typically more cost-reflective, as they take into account the different costs of supplying electricity in peak, shoulder and off-peak periods of demand (see Box 4.1 for more detail).

A typical example of a time-of-use offer in the Ausgrid network advertised on Energy Made Easy in July 2018 included:

- a daily supply charge of 96 c per day
- a peak consumption tariff of 54 c/kWh
- an off-peak tariff of 15 c/kWh
- a shoulder tariff of 23 c/kWh, and
- a discount of 22% applied to the usage charges only.[110]

As of July 2018, Ausgrid introduced a seasonal network tariff structure, whereby the time periods that are classified as peak, off-peak and shoulder vary, depending on the time of the year. Under this seasonal time-of-use structure, the number of hours in the peak period decreased from six in summer (2 pm to 8 pm) to four in winter (5 pm to 9 pm). During spring and autumn, there is no peak period at all, this has been replaced by an extension of the shoulder period.[111]

108 These tariffs are reported exclusive of GST.
109 As at June 2018, around 5% of customers in each region had smart meters. An additional 24% of Ausgrid customers had interval meters. Data provided by AEMO July 2018.
110 These tariffs are reported exclusive of GST.
111 Ausgrid, *Time-of-use pricing*, https://www.ausgrid.com.au/Connections/Meters/Time-of-use-pricing, accessed 21 November 2018.

A stakeholder submitted to our Information Paper that retailers had not adjusted their tariff structures to reflect Ausgrid's seasonal changes.[112] According to Energy Made Easy data in July 2018 only three retailers were offering seasonal time-of-use structures, while most retailers continued to offer all year round time-of-use pricing. Of the retailers offering seasonal time-of-use pricing, some retailers had adjusted their tariff levels to reflect Ausgrid's changes in time periods, while others had not. Ultimately, retailers have discretion over their pricing structure and how they choose to recover costs.

When we compared bill estimates for the three retailers who had introduced seasonal time-of-use pricing between June and July 2018, we found that bills for both their lowest and standing offers advertised on Energy Made Easy had decreased for the same consumption profile.

4.2.2 Demand tariffs available in a small number of offers

One retailer (CovaU) was offering demand tariffs in July 2018 for residential customers. Demand tariffs are an additional tariff that can be combined with either all-day or time-of-use tariffs. It is a price based on a customer's maximum demand for electricity at a point in time during predetermined 'peak windows.' These peak windows are determined by times that the network typically experiences peak aggregate demand. Consumption that falls outside of this peak window does not contribute to the demand charge component of the bill, but will still be subject to standard usage charges.[113]

Like time-of-use tariffs, demand tariffs are more cost-reflective than all-day tariffs.

As at July 2018, CovaU's three available offers in the Essential network with demand tariffs included:

- a demand tariff of 3.91 c/kW/day, based on the highest measured half-hour of demand registered in either peak or shoulder periods during the month
- a daily supply charge of 170 c per day
- a peak tariff of 25 c/kWh
- an off-peak tariff of 18 c/kWh
- a shoulder tariff of 23 c/kWh
- discounts that varied from 0% to 25% off the total bill.[114]

112 Anonymous submission to IPART Information Paper, July 2018.
113 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 175.
114 Energy Made Easy, accessed July 2018, tariffs reported exclusive of GST.

Box 4.1 Cost-reflective pricing

Time-of-use and demand tariffs structures can ensure customers pay more cost-reflective prices, and over time should help to reduce prices for customers overall, by reducing the need for network investment which is driven by meeting demand during critical peak periods.

Because network costs make up a substantial portion of customer bills, ensuring that these costs are kept as low as possible and are allocated fairly across all customers plays a key role in reducing energy costs for consumers overall. The Productivity Commission found that peak demand events in NSW account for around 25% of energy bills, but only occur for less than 40 hours per year. Although the frequency of this level of demand for electricity is relatively low, it contributes materially to network investment and consequently, the overall cost of electricity for consumers.

Cost-reflective tariffs should signal to customers that peak usage drives costs, and indicate **when** customers should reduce their usage, in addition to **how much** they should reduce their usage. They should also signal to customers when to source energy from the grid, and when to source energy from alternative sources, ie solar panels and battery storage. These changes to consumption patterns should reduce costs incurred by the networks and therefore reduce overall costs passed onto customers. The transition to cost-reflective pricing should also ensure that costs are fairly allocated between customers, relative to the costs that they impose on the networks.

Source: ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 173-79; Productivity Commission, *Electricity network regulatory frameworks,* Inquiry report, Volume 1, April 2013, p 16, 79.

4.3 Wide variation in electricity price offerings

For each traditional electricity tariff type (all-day and time-of-use taffifs), we compared each retailer's standing offer and market offers as at the end of July 2018. Generally, a retailer's standing offer will be its highest offer (Box 4.2). To compare these offers, we calculated the annual bill for a typical customer using 5,100 kWh per year (Box 4.3). We found a substantial difference between the standing offers of different retailers, as well as a large difference between individual retailers' standing offer and lowest priced offer.

Box 4.2 Standing and market 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
- There is a minimum amount of time before customers can be disconnected if they do not pay their bill.

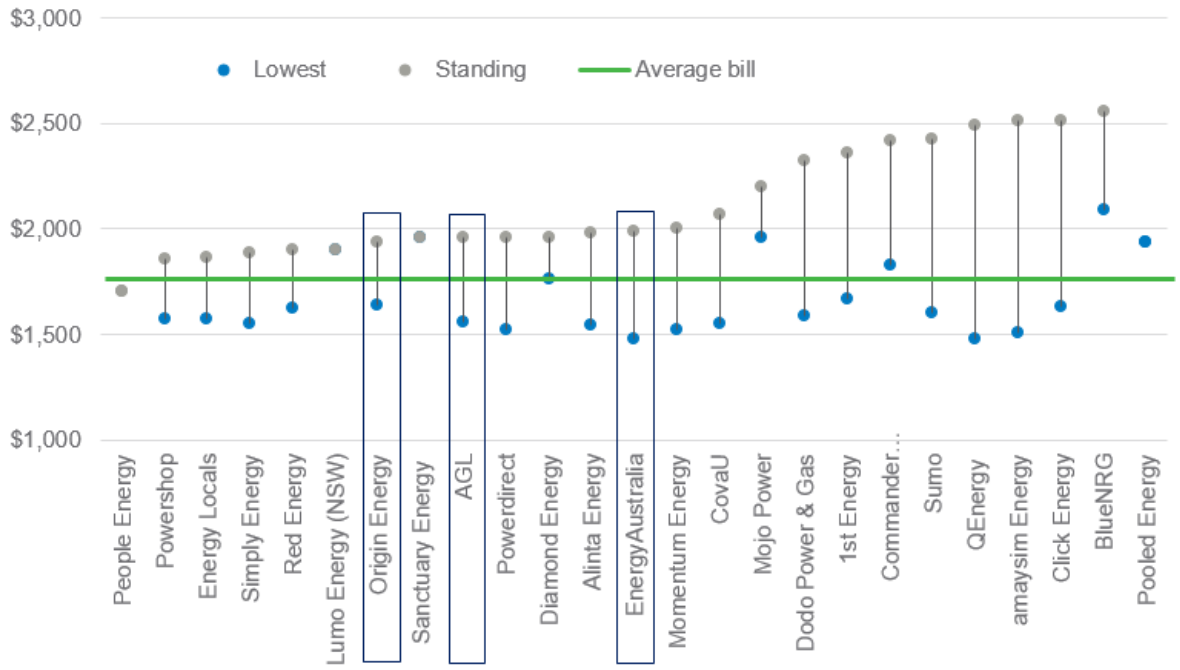
Source: AEMC, *2018 Retail energy competition review,* Final Report, 15 June 2018, p 49.

4.3.1 Most expensive all-day tariff offer was around 70% higher than cheapest

Figure 4.1 shows the difference between the bills for each retailer's all-day standing offer and lowest offer. For many of the smaller retailers, their standing offers were significantly higher than those of the big three retailers (marked with a border). The average difference between the standing and lowest offers across all 22 smaller retailers was 34%, while for the average

difference across the big three retailers was 26%.[115] The most expensive all-day tariff offer available in 2017-18 was around 70% higher than the cheapest offer available. Figure 4.2 shows that this spread of offers has increased significantly over time.

Figure 4.1 Electricity bills for residential Ausgrid customers on all-day tariffs (5,100 kWh pa, nominal, GST-inclusive)

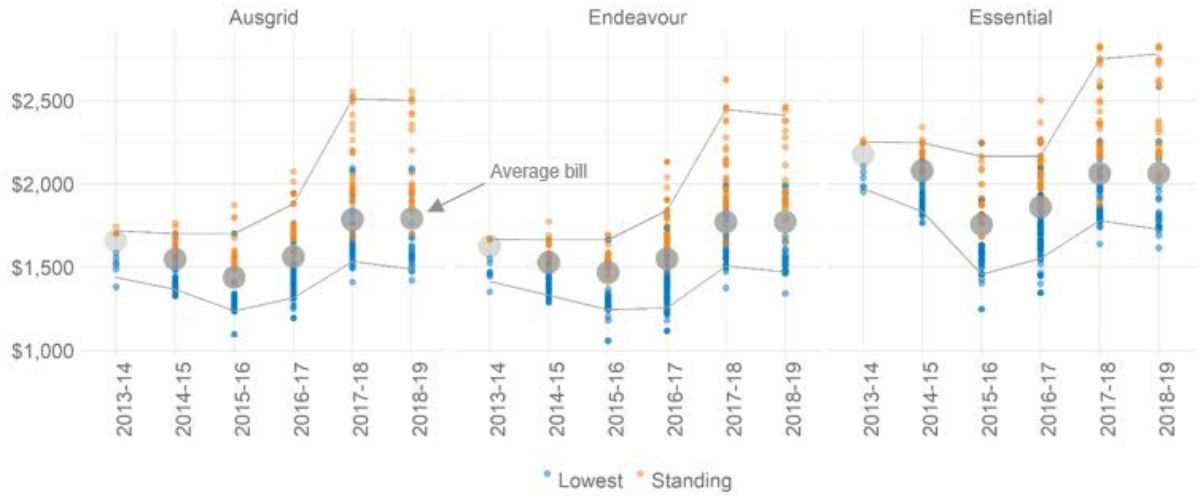


Note: Bills are calculated taking into account all available conditional and non-conditional discounts. The standing offer for Pooled Energy was not available on the Energy Made Easy website.

Data source: Energy Made Easy, accessed September 2018.

115 We note that AGL and Red Energy have recently announced that they will be giving a 10% discount to its standing offer customers commencing 1 January 2019. AGL, *AGL announces safety net for electricity customers*, https://www.agl.com.au/about-agl/media-centre/asx-and-media-releases/2018/november/agl-announces-safety-net-for-electricity-customers, accessed 22 November 2018. Australian Financial Review, *Snowy Hydro to reduce standing offers as CEO slams 'stupid' rules,* https://www.afr.com/business/energy/electricity/snowy-hydro-to-reduce-standing-offers-as-ceo-slams-stupid-rules-20181129-h18j6d, accessed 30 November 2018.

Figure 4.2 The range of offers across all networks since 2013-14 (5,100 kWh pa, nominal, GST-inclusive)



Note: Bills are calculated taking into account all available conditional and non-conditional discounts.
Data source: Energy Made Easy and information from retailers.

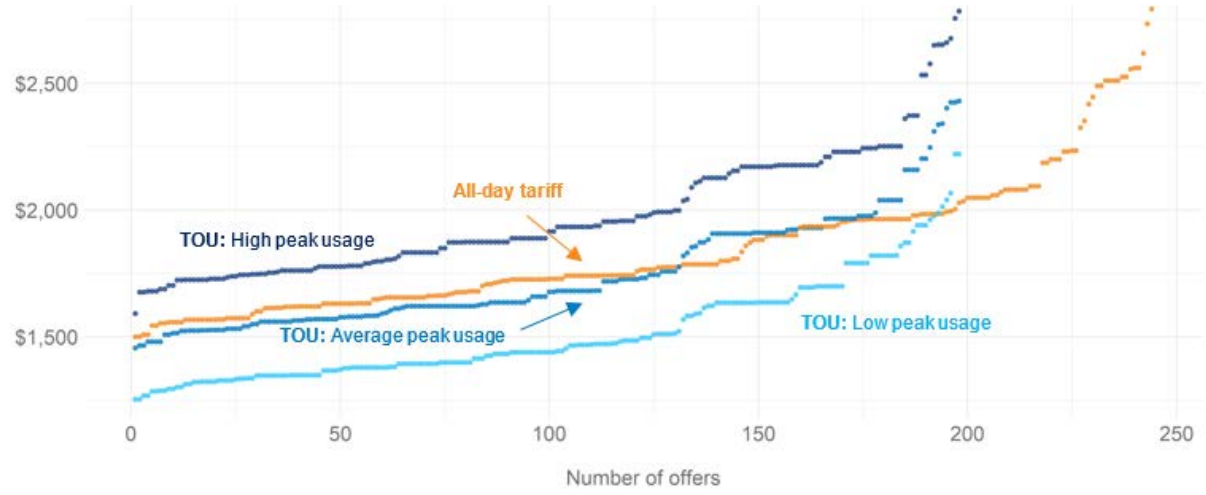
4.3.2 The relative price of time-of-use offers depends on the consumption profile

Like all-day tariffs, there is a large range of available time-of-use offers in the market. Figure 4.3 shows the spread of available all-day offers against the time-of-use offers with three different scenarios for peak usage.

Based on the average usage consumption profiles of existing time-of-use customers (see Box 4.3), time-of-use offers for customers with average peak usage are slightly cheaper than the all-day offers. However, the relative price of a time-of-use offer will depend on the consumption profile of an individual.

Customers with a higher level of consumption in the peak (high-peak users) can expect to pay around 10% more on a time-of-use plan than an all-day offer. For a low peak user, the saving on an annual bill with a time-of-use offer is around 15%.

Figure 4.3 Spread of all-day offers compared with time-of-use offers for different customer usage profiles (5,100 kWh pa, nominal, GST-inclusive)



Note: Bills are calculated taking into account all available conditional and non-conditional discounts. Scenarios for TOU tariffs based on IPART assumptions for peak usage as a share of total daily consumption. These were 10% for the 'low peak usage' and 20% and 35% for the average and high peak usage scenarios respectively.

Data source: Energy Made Easy, IPART calculations.

Box 4.3 Consumption for a "typical" customer

Throughout this report, we have calculated electricity bills for consumption of 5,100 kWh per year.

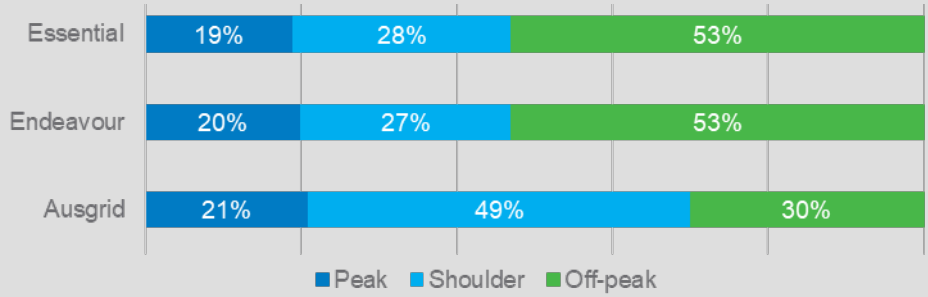
In previous years, we have calculated an electricity bill for a typical customer using 6,500 kWh per year, based on IPART's household surveys. Since the last household survey was completed in 2015, a more recent survey was conducted by ACIL Allen for the AER's energy consumption benchmarks, which are published on customer bills and used to calculate bills on the AER's Energy Made Easy website. This year we have updated the consumption of a typical customer based on the average consumption from the ACIL Allen survey, because it is more recent source of information, and it is used for a variety of purposes.

A household consuming 5,100 kWh per year most closely reflects a two-person household in metropolitan NSW. This consumption rises to an average of 5,400 kWh and 6,600 kWh for three-person households and four person households' respectively. The average consumption for a one-person household is 3,400 kWh.

ACIL Allen's surveys showed that the average level of electricity consumption fell across almost all jurisdictions since it was first conducted in 2011.

For time-of-use offers, we calculated bills for the typical customer using 5,100 kWh, and used the average proportion of consumption for each time period for time-of-use customers in each network area, as shown in the figure below. However, for the same consumption level, customer bills vary significantly depending on when the energy is being consumed (see Figure 4.3 above).

Time-of-use consumption for a typical customer using 5,100 kWh per annum



Note: These assumptions are based on existing time-of-use customers in a given period and do not necessarily reflect the consumption profile of a typical 'all-day tariff' customer.

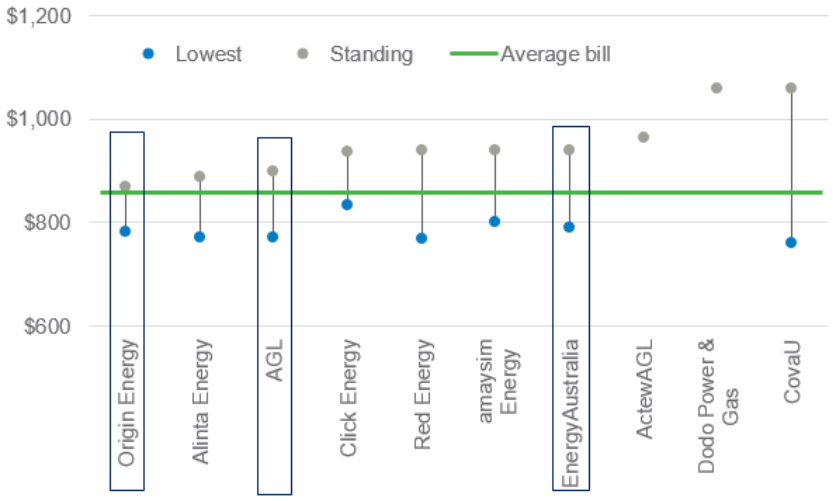
For gas customers we also used ACIL Allen's consumption estimate for NSW customers based on the bill benchmark survey. The average level of consumption for coastal customers in the Jemena network is around 20 GJ, while country residential customers serviced by Australian Gas Networks (AGN) consume around 41 GJ per year. Customers in the Central Ranges Tamworth network area consume around 7 GJ per annum, which is substantially lower than average consumption for customers in other parts of NSW.

Source: ACIL Allen, *Energy Consumption Benchmarks, Report to Australian Energy Regulator,* October 2017, pp 26, 30. Information provided by networks, IPART calculations.

We also compared each gas retailer's standing offer and market offers as at the end of July 2018. We calculated the annual bill for a typical customer in the Jemena network using 20 GJ per year. As for electricity, we found a significant difference between the standing offers of different retailers, as well as a large difference between individual retailers' standing offer and lowest priced offer.

On average, the difference between the lowest offers and standing offers across gas retailers is around 20%, or around $170 for a typical customer (Figure 4.4). The highest price offer in the gas market is around 35% higher than the least expensive.

Figure 4.4 Spread of gas offers for coastal customers (20 GJ pa, nominal, GST-inclusive)



Note: Bills inclusive of all discounts.

Data source: Energy Made Easy, accessed September 2018.

4.4 Discounts to standing offers the main way to attract customers

During 2017-18, retailers continued to advertise price discounts relative to a standing offer as the main way to attract customers. In addition, these headline discounts became higher, with the maximum discount being around 35%.[116] The AEMC found that many retailers reported that discounting is still one of the most effective ways to attract customers, and that moving away from discounting is likely to result in losing customers in the short term.[117]

However, undiscounted products are also becoming more common. As of July 2018, 20% of gas and electricity market offers across the NEM had no discounts attached to them.[118] As more customers become aware that discounting does not necessarily lead to lower bills, many retailers are also marketing '0% discount' low price offers.[119]

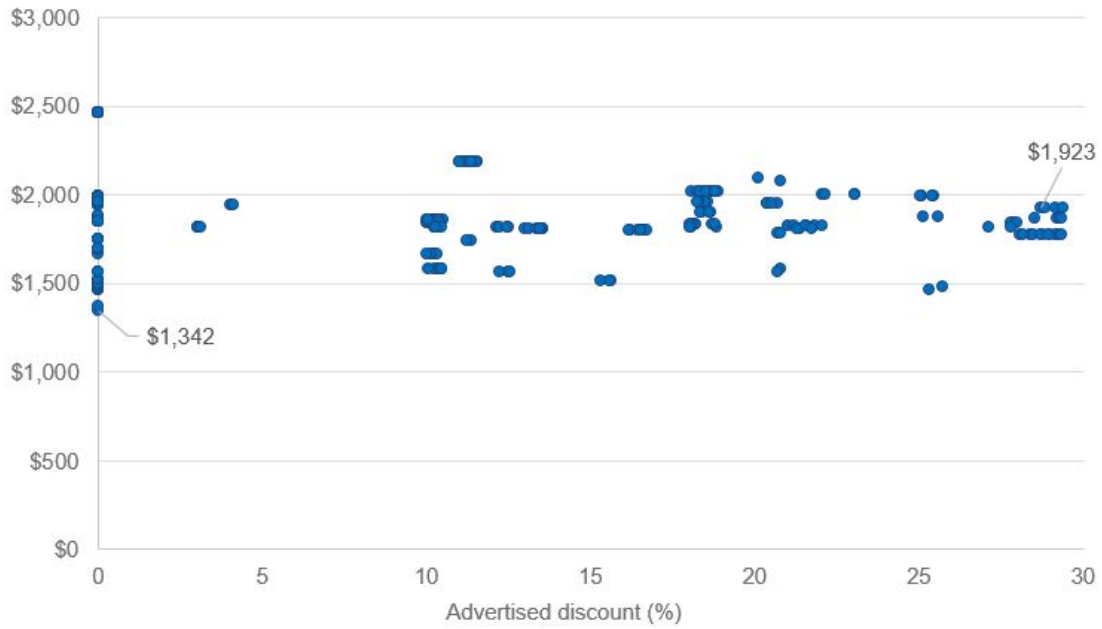
116 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 57.
117 *Ibid,* p 63.
118 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 54.
119 Offered by Momentum Energy, Energy Locals, Pooled Energy, Mojo Power, ERM Power, AGL and Lumo Energy. *Ibid,* p 64, AGL submission to IPART Draft Report, November 2018, p 2.

It is hard to compare retailers' discounts, as they are applied to different underlying tariffs, and some retailers apply discounts to the whole bill, and others apply discounts to the usage component only. 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%).[120] 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).[121]

Higher advertised discounts often reflected higher underlying prices, rather than a better deal for customers. Figure 4.5 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.

A new rule was made in 2018 that retailers cannot advertise discounts off an offer that is higher than their standing offer.[122]

Figure 4.5 Annual bill by advertised discount (based on the Endeavour network, 5,100 kWh pa, GST-inclusive)



Data source: Energy Made Easy, accessed September 2018.

Most discounted offers were also conditional on customers meeting certain requirements. Around 60% of all market offers in the NEM had at least one conditional discount, and only 25% had discounts that were not conditional.[123] The ACCC found that on average, 27% of the customers on these offers with conditional discounts would have paid considerably higher offer rates because they did not meet the discounting condition.[124]

120 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 57.
121 *Ibid,* pp 57-58.
122 AEMC, *Preventing discounts on inflated energy rates,* https://www.aemc.gov.au/rule-changes/preventing-discounts-on-inflated-energy-rates, accessed 27 September 2018.
123 *Ibid,* p 54.
124 ACCC, *Restoring electricity affordability & Australia's competitive advantage,* June 2018, p 29.

The most common of these conditions was that the customer pays their bill on time. Other conditions were receiving bills online, paying by direct debit, and having multiple accounts with the retailer. One retailer, 1st Energy, introduced a discount on the condition that the customer does not switch away (ie, "If you change retailer at your current supply address, there will be no discount on the final bill").[125]

4.5 Most retailers are not using price to target different customer segments

As outlined above, electricity and gas offers are typically made up of a number of different tariff components, including a supply charge, and different consumption charges. Depending on the relativities between these tariffs, customers with different usage profiles could 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. In contrast, a high consumption customer 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 times of the day.

In a highly competitive market, we would expect to see retailers tailoring their offers to these different household consumption profiles. PIAC submitted that the AEMC found that price dispersion is driven primarily by discounting practices rather than targeting different customer segments.[126] In general, our analysis is consistent with this finding and is set out in the section below.

However, we have found some examples of retailers tailoring their offers to other customer preferences, such as predictable billing, high solar-feed in tariffs, and other green credentials.

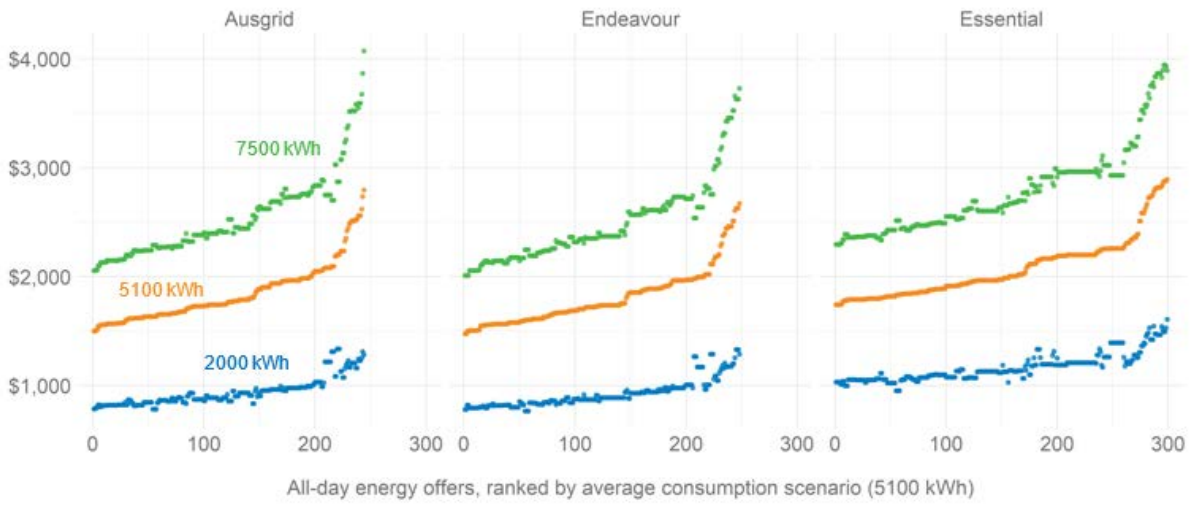
4.5.1 Retailers are not tailoring to different consumption profiles

If retailers were targeting specific types of consumption preferences, we would expect to see the relative value of these deals change with different levels of usage. To test this we examined the range of offers in the market assuming a consumption level of 5,100 kWh and ranked them from lowest to highest. We then tracked these same offers at different levels of consumption (7,500 kWh and 2,000 kWh). These high and low usage scenarios are roughly consistent with a five person household and a single person household.

Figure 4.6 shows the relative value of any particular offer in the market is generally disconnected to the level of consumption. That is, any plan in the cheapest 10% of offers for an average customer will also be in the cheapest 10% for a high-use or low-use consumer.

125 *Ibid*, p 55.
126 PIAC submission to IPART Information Paper, August 2018, p 1.

Figure 4.6 Range of residential all-day offers under different levels of consumption (nominal, GST-inclusive)



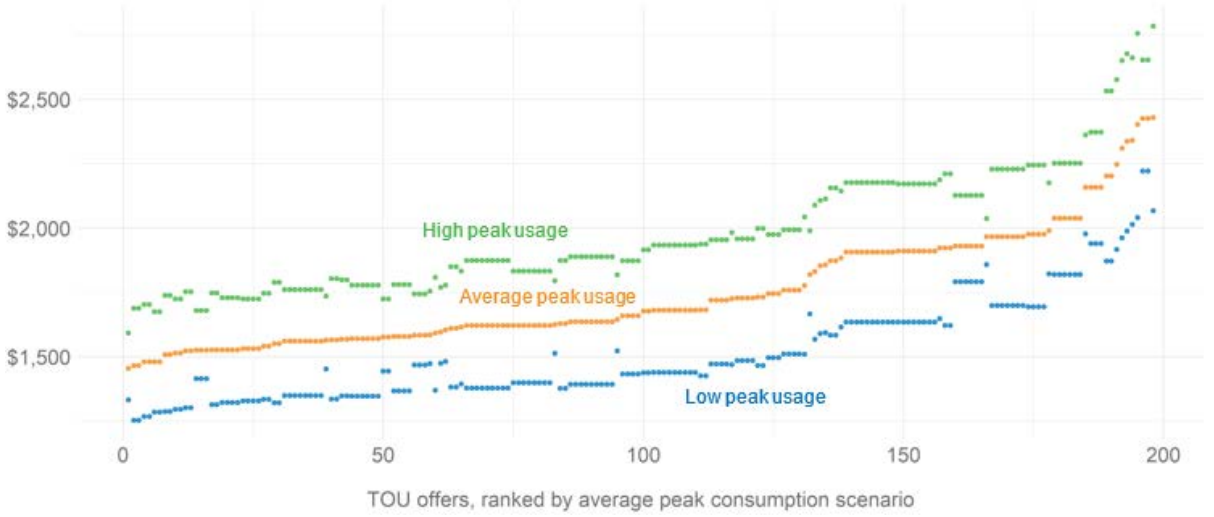
Data source: Energy Made Easy, accessed June 2018, IPART calculations.

For time-of-use customers, there is also little evidence of retailers tailoring offers to particular consumption preferences. In a highly competitive market we would expect to see retailers target customers who consume more energy in peak periods against lower peak-use customers.

To test this we examined the range of time-of-use offers available in the Ausgrid network assuming usage of 5,100 kWh and an average level of peak consumption. We then tracked these same offers with different assumptions for peak usage to see if the value range changed.

Figure 4.7 shows that similar to the all-day tariff structures, the relative price of a particular offer in the market was generally not connected to the consumption profile. Customers who use a lot of energy during the peak window would expect to pay more (reflecting a higher cost of provision) but this premium is relatively unchanged across the spectrum of offers.

Figure 4.7 Range of time-of-use offers for different consumption profiles in Ausgrid network area (5,100 kWh pa, GST-inclusive)



Data source: Energy Made Easy, accessed June 2018, IPART calculations

While the overall structure of time-of-use tariffs doesn't vary materially among retailers, small differences in the peak, shoulder and off-peak tariffs will mean that the absolute lowest offer for a particular customer will depend on their individual consumption profile.

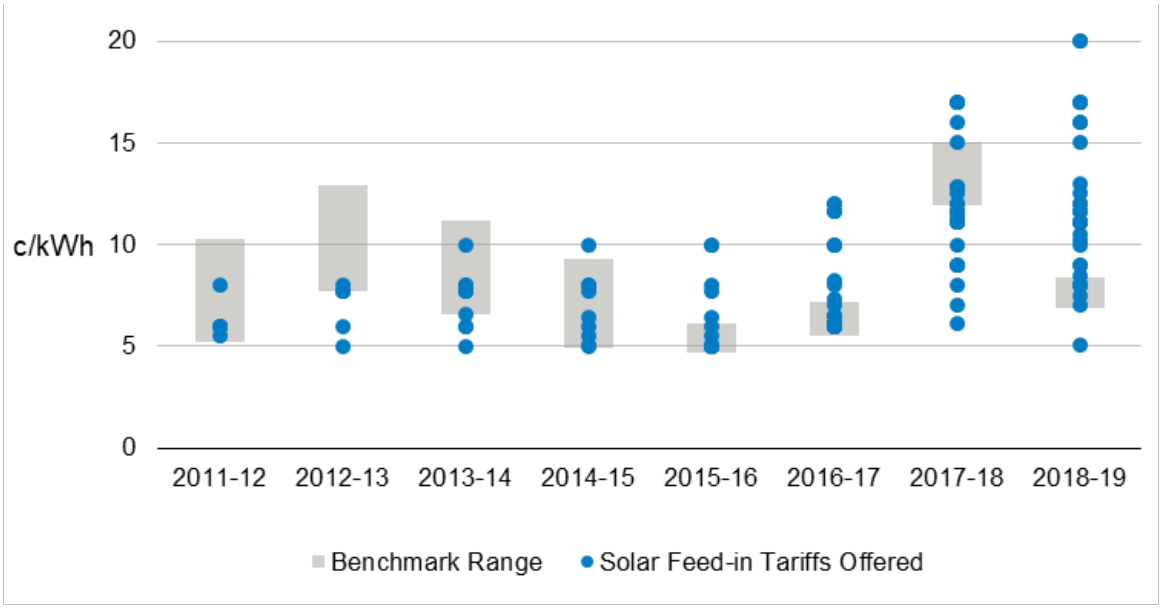
4.5.2 Some offers are tailored to other preferences

We found that retailers had also started to offer other alternatives to traditional tariff structures to appeal to different market segments. For example, for customers who value predictability of their energy bills, Origin Energy introduced 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.[127] There are also examples of locked in **rates** for customers. 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[128], and AGL Essentials products have fixed rates for 12 months.[129]

It is also common for retailers to differentiate themselves through their solar feed-in tariff offering. Each year IPART sets a solar feed-in tariff benchmark range to reflect the likely value of solar energy to the retailer (based on value of avoided costs of purchasing the equivalent energy from the wholesale market at the times that solar is being exported to grid). However over the most recent years, retailers have been competing to offer higher solar feed-in tariffs to attract solar customers. Figure 4.8 shows that there is now a very wide range of feed-in tariffs being offered to customers, with the vast majority above the IPART benchmark range for 2018-19.

127 Origin, *Predictable Plan,* https://www.originenergy.com.au/for-home/campaign/origin-predictable-plan.html, accessed 20 September 2018.
128 EnergyAustralia, *Secure Saver,* https://www.energyaustralia.com.au/home/electricity-and-gas/understand-electricity-and-gas-plans/secure-saver, accessed 27 September 2018.
129 AGL submission to IPART Draft Report, November 2018, p 2.

Figure 4.8 Solar feed-in tariffs over time compared to IPART's benchmark (2011-12 to 2018-19, nominal $)



Note: 2018-19 solar feed-in tariffs as at September 2018.
Data source: Energy Made Easy, IPART calculations.

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.[130]

4.6 Retailers are 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 continued to develop in 2017-18. Sign-up incentives (such as bill credits when they refer a customer[131]), movie tickets, airline points[132] and retailer-specific reward schemes were common.[133] Retailers also commonly offered electricity and gas together.[134] Dodo, Amaysim and most recently Origin Energy[135] also supply customers in both the energy and broadband markets.

In addition, retailers started to offer digital meters, solar PV, and battery options to their customers, in addition to traditional energy services.[136] For example, EnergyAustralia and

130 Energy Made Easy.
131 Diamond Energy, *Refer a friend and both receive $35 credit!*, http://diamondenergy.com.au/diamond-referral/, accessed 27 September 2018.
132 For example, see Red Energy, Earn Qantas Points for being a Red Energy customer. https://www.redenergy.com.au/qantas/, accessed 27 September 2018.
133 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 68.
134 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.
135 Origin Energy announced in October 2018 that it had entered the broadband market, see Origin Energy, *Internet Broadband*, https://www.originenergy.com.au/for-home/nbn-internet-broadband.html, accessed 23 October 2018.
136 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.

Origin Energy offered solar panels, inverter and installation, as well as battery storage systems.[137] Enova Energy indicated it plans to develop options to make solar take-up attractive to landlords and renters.[138] It also became more common for retailers to provide customers with information about their electricity usage through an app.[139]

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.[140] For example, Powershop allows customers to pre-purchase units of energy when it is convenient and offers periodic sales and discounts.[141]

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, and customer demand-response options become valuable to retailers (that is, customers agreeing not to use energy in times of peak demand, and a value being assigned to this avoided consumption).

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.

137 EnergyAustralia, *Solar Power Systems,* https://www.energyaustralia.com.au/home/solar-and-batteries/solar-power/solar-power-systems, accessed 27 September 2018.
138 Enova Energy, *About Enova*, https://enovaenergy.com.au/about-us/, accessed 27 September, 2018.
139 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.
140 Australian Energy Council submission to IPART Information Paper, August 2018, p 1.
141 Powershop, *Powerpacks, https://www.powershop.com.au/powerpacks/,* 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. 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 looked at awareness of retail competition, switching rates, and customers' contract types. We also examined the reasons why some customers do not participate in the market.

We relied primarily on the AEMC's competition reviews. In previous years, the AEMC commissioned its own survey of residential customers, but this year it has only commissioned a survey of business customers. For residential customers, it relied on the results of a different survey undertaken by the Energy Consumer Australia.[142] Therefore, our analysis in this chapter refers to both the results of the AEMC's most recent survey of residential customers in 2017, and the AEMC's reporting of the 2018 survey results of the Energy Consumer Sentiment Survey.

The sections below outline our findings and then discuss them in more detail.

5.1 Overview of findings

Compared to those in other countries, Australian customers are relatively engaged in the energy market.[143] In NSW, customer participation in the electricity market remained high in 2017-18, and the proportion of those on market offers increased substantially. Customer participation in the gas market also increased.

In line with previous years, around 20% of residential customers reported that they intend to switch retailer in the next 12 months. While not participating actively in the market may be a rational choice for many consumers, the difficulty of comparing offers continued to constrain customer engagement. For example, the proportion of customers who reported they felt confident that they could find the best deal for them fell in 2017-18 compared to the previous year.

Governments and regulators are already implementing a range of measures to make it easier for customers to compare offers. These include new measures or improvements to existing measures that have only recently come into effect.

142 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 2.
143 Oxera, *Behavioural insights into Australian retail energy markets – Report for the Australian Energy Market Commission*, 11 March 2016, p 27.

5.2 Customer participation in electricity market remained high in 2017-18

The AEMC's findings on customer participation indicate that the level of participation in the electricity market in NSW remained high in 2017-18 (Table 5.1). Almost all customers were aware they can choose their electricity retailer. In addition, 19% switched electricity retailers during the year, up slightly compared to previous years. The AEMC did not report on the number of customers who switched plan with the same retailer in 2017-18. However, this has tended to remain fairly constant for previous years at just under 20%.[144]

Retailer submissions support the AEMC's findings. For example, AGL submitted that its customer churn rate across the NEM increased from 16.4% to 18.9% in 2017-18, while acquisitions and retentions have increased by 25%. It submitted that this demonstrates that customers are heavily engaged and the competitive environment has intensified.[145]

The AEMC's findings also indicate customer switching rates for electricity providers are higher than those for other products and services. In the five years to 2017, 39% of consumers surveyed had switched electricity providers, whereas 36% had switched car insurers, and 34% had switched mobile providers.[146]

Table 5.1 Summary of participation indicators (NSW)

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	Switched company at least once in year[a]	15%	16%	17%	19%
		Switched plan with same company in year	NA	18%	15%	19%
	Business	Switched company at least once in year	NA	17%	12%[a]	19%[a]
		Switched plan with same company in year	NA	20%	15%[a]	11%[a]

a Updated data from AEMC, *2018 Retail energy competition review*, Final Report, June 2018, pp 97-98, 121. Other data in the table comes from Newgate Research.

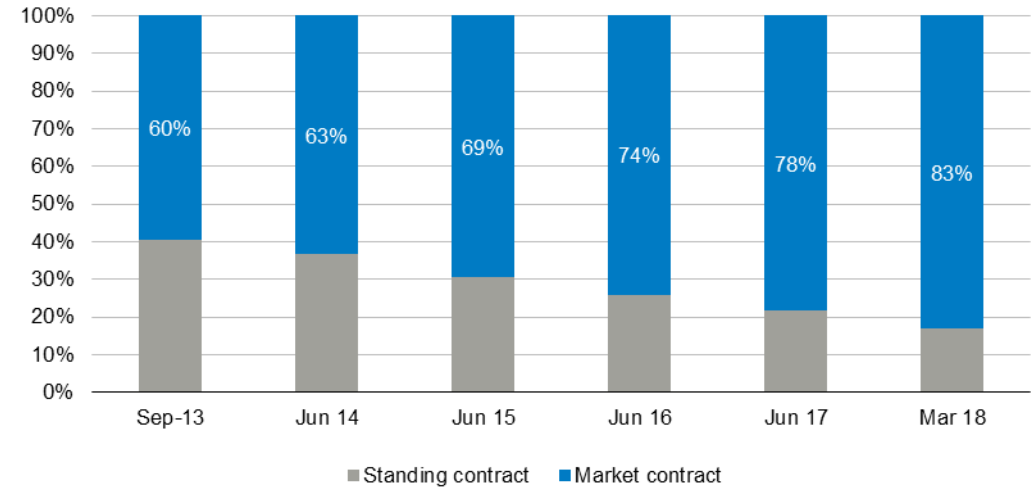
Data source: Newgate Research, *Consumer research for the Australian Energy Market Commission's 2017 retail competition review*, April 2017, pp 102-116.

As Chapter 4 explained, standing offers are the default offers for customers who have not engaged in the market at their current supply address. Some customers will also be on standing offers because their market offer has expired.[147]

144 Newgate Research, *Consumer Research for the Australian Energy Market Commission's 2017 Retail Competition Review*, April 2017, p 106.
145 AGL submission to IPART Draft Report, November 2018, p 1.
146 AEMC, *2017 Retail energy competition review,* Final Report, July 2017, p ii.
147 Most market offers do not 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 proportion of customers on market offers (for both residential and business customers). In the year to June 2017, this proportion grew from 74% to 78%, and as of March 2018 it had jumped further to 83%. This jump 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.[148]

Figure 5.1 Proportion of standing and market contracts in NSW



Data source: AER, NSW – Small retail customer contract types, accessed 10 September 2018. We note that this information may have data errors relating to AGL customers and may be updated in the future. However we have reported this information because it is remains the best available data source.

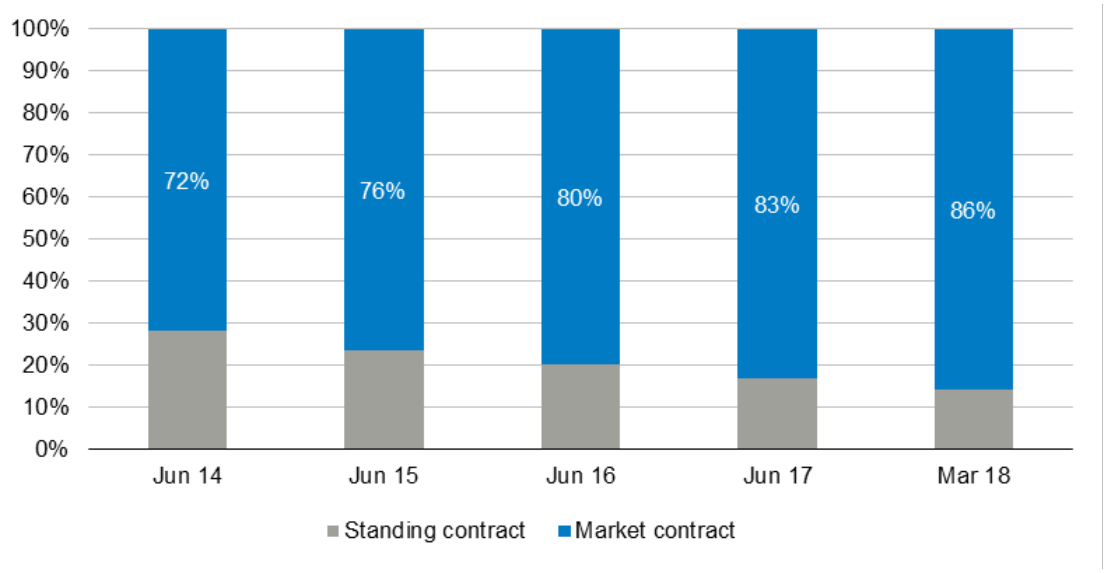
5.3 Customers participation in the gas retail market increased

The AEMC's findings indicate that customer participation in the retail gas market in NSW increased in 2017-18. While the switching rate for gas customers was still lower than for electricity customers, it increased to 14% in 2017-18. This was higher than in the past four years (when it was at around 10%),[149] and was the second highest switching rate for gas customers in the NEM.[150] In addition, 86% of all gas customers were on a market offer, rather than a 'standing' or default offer (Figure 5.2), up from 83% last year before gas prices were deregulated.[151]

However, 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.[152]

148 AEMC, *2018 Retail energy competition review,* Final Report, June 2018, p 50.
149 *Ibid*, p 271.
150 *Ibid*, p 83.
151 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.
152 PIAC submission to IPART Information Paper, August 2018, p 3.

Figure 5.2 Proportion of gas customers on 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. We note that this information may have some data errors relating to AGL customers and may be updated in the future. However we have reported this information because it is remains the best available data source.

5.4 Difficulty of comparing offers continued to constrain customer engagement

For the past few years, around 20% of residential customers reported that they are intending to switch retailer in the next 12 months.[153] We do not consider that this is necessarily a problem. For many customers, not participating in the market is a rational choice. For example, 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 had not investigated switching).[154]

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. 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.[155]

In addition, the AEMC found that the main motivation for customers to switch retailer or plan was to reduce their bill,[156] but customers said that to seriously consider switching retailer or plan, they would need to make a significant saving. In 2017, residential customers wanted to

153 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 100.
154 Newgate Research, *Consumer Research for the Australian Energy Market Commission's 2017 Retail Competition Review*, April 2017, p 39.
155 *Ibid*.
156 *Ibid*, p 38.

save an average of $388 per year on their electricity bill,[157] and small business customers wanted to save about $1,284 per year ($488 more than last year).[158]

5.4.1 Some customers find comparing and identifying best offer confusing

In its most recent customer 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.[159] In addition, fewer customers reported that they can find the right information to help them compare offers:

- 49% of NSW residential customers said they are confident they could access easily understood information in April 2018, compared to 62% April 2017[160]
- 79% of business customers (NEM-wide) reported that they are confident down from 89% in 2017.[161]

Residential customers also thought the process of comparing and selecting energy offers is more complex than comparing and selecting other services, such as home/car/health insurance, internet and telecommunication plans, or banking services.[162]

Stakeholders making submissions to our review supported these findings. For example, PIAC submitted that customers are remaining on high-priced offers due to complex and confusing tariff structures.[163] An individual stakeholder said that retailers do not make it easy to find out what the discount is being compared to, and that customers assume they get the advertised percentage discount off their current prices.[164] Another stakeholder 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.[165]

5.4.2 Good measures to help customers are available but awareness remained low

We agree it can be difficult for some customers to compare electricity market offers. This is because they are made up of several different tariff components – including a supply charge, different consumption charges that sometimes vary by time of day, and discounts that can be applied to some or each of these components. As Chapter 4 discussed, customers cannot rely on headline discounts to compare offers, because the base rate from which the discounts apply vary across retailers and plans.

However, governments and businesses do have measures in place to help customers. The AER already publishes independent comparisons of retailers' energy offers through its

157 *Ibid*, pp 46-47.
158 *Ibid*, pp 46-47, AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 124.
159 Newgate Research, *Consumer Research for the Australian Energy Market Commission's 2017 Retail Competition Review*, April 2017, p 40.
160 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 90.
161 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 120.
162 Newgate Research, *Consumer Research for the Australian Energy Market Commission's 2017 Retail Competition Review*, April 2017, p 27.
163 PIAC submission to IPART Draft Report, November 2018, p 2.
164 G, Moss, Individual submission to IPART Information Paper, June 2018, p 1.
165 D, Davidson, Individual submission to IPART Information Paper, May 2018, p 1.

Energy Made Easy website. This website calculates the annual bills the customer would face under different market offers on a consistent basis, using their actual historical energy usage or their household characteristics, and ranks them by price. This makes it easy for customers to compare a large number of offers, and to assess their suitability for their individual circumstances. The AER made major upgrades to Energy Made Easy in September 2018 to improve its user-friendliness – for example, by 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.[166]

In addition, in November 2018, the NSW Government launched 'Energy Switch', to make it easier for customers to compare their current offer with the offers available. It identifies cheaper offers for customers, how much they would save, and provides an option to initiate a change of retailer. It is offered both online and at ServiceNSW centres.[167]

There are also a large number of privately run comparator websites that can help customers compare and switch offers. Further, in response to our Draft Report, Origin submitted that it helps customers confidently engage in the market with its 'Savernator' dollar-value comparison tool, which presents offers in dollars-per month on its website (rather than a discount rate).[168]

In addition, in August 2018, changes to the Retail Pricing Information Guidelines (RPIG) commenced,[169] 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.[170] This will ensure a customer is provided with consistent and clear information.

We consider Energy Made Easy is a good tool for customers to compare offers. The main issue with this website is that many customers remain unaware that it exists. For example, last year, similar to previous years, the AEMC found that only 13% of customers in NSW were aware of Energy Made Easy.[171] We support the ACCC's recommendation that the Government commit to ongoing funding to raise awareness of the government-run comparator websites.[172]

We also consider that Energy Made Easy could be further improved as 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,[173] Energy Made Easy does not factor in the feed-in tariff revenue that a household is likely to receive. It is also unable to compare offers with demand

166 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 102.
167 NSW Government, *'Energy Switch to save households hundreds of dollars,* November 2018, https://www.nsw.gov.au/your-government/the-premier/media-releases-from-the-premier/energy-switch-to-save-nsw-households-hundreds-of-dollars/, accessed 28 November 2018.
168 Origin, p 3.
169 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.
170 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, pp 108-109.
171 Newgate Research, *Consumer Research for the Australian Energy Market Commission's 2017 Retail Competition Review*, April 2017, p 107.
172 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 286.
173 IPART, *Solar feed-in tariffs, The value of electricity from small-scale solar panels in 2018-19*, June 2018, p 1.

tariffs.[174] However, we note that we provide a tool on the IPART 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.

The 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. We support recent recommendations by the AEMC and ACCC to ensure that these websites deliver outcomes that are in the best interests of customers.[175]

174 Demand charges (measured in kilowatts or kVA) 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.

175 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

In line with our role as energy market monitor, we assessed the changes in electricity prices and the underlying costs of supplying electricity in 2017-18. In response to a request from the Minister, we had regard to the ACCC's findings about prices and costs up until the end of 2017-18, as part of its recent inquiry. We also extended our assessment to include the most recent changes at the start of 2018-19. In a competitive market, we would expect that the change in prices broadly reflects the changes in the underlying market costs of supply.

The sections below summarise our findings, and then discuss them in more detail. Chapter 8 provides our assessment of the changes in gas prices and costs.

6.1 Overview of findings on changes in electricity prices

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.

While electricity prices remained stable, we estimate that the underlying costs decreased by around 10% into 2018-19.[176] This is mainly due 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).[177]

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

Based on these findings, we do not consider that a detailed review of retailer profit margins is necessary at this time.

6.2 Prices remained relatively flat in to 2018-19

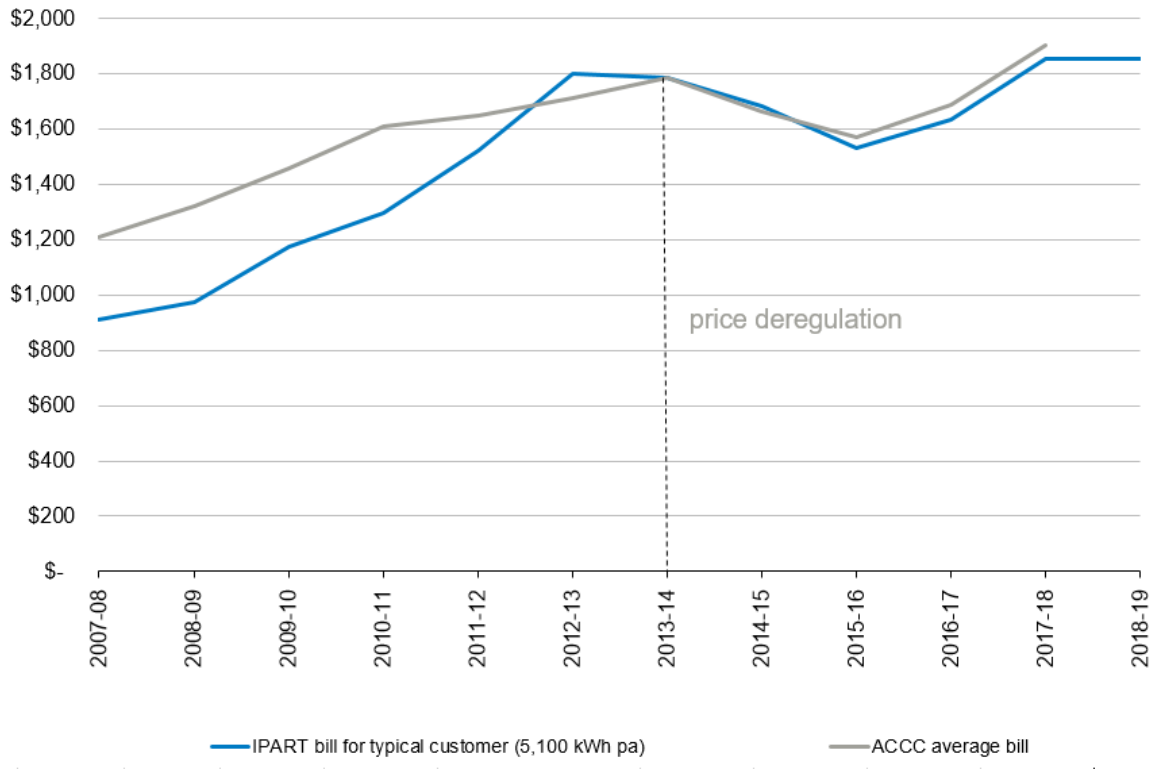
We estimate that the average retail electricity prices for residential and small business customers increased by 0.2% in the period from 2017-18 to 2018-19 in all three network areas

176 Using a point-in-time approach to measuring wholesale costs. In our Draft Report, we estimated that the change in costs was 9%, in line with ACIL Allen's draft findings. This has been updated between their Draft and Final Reports. ACIL Allen, *Cost drivers of recent retail electricity prices for small NSW customers,* September 2018, p iii. ACIL Allen, *Cost drivers of recent retail electricity prices for small customers in NSW,* November 2018, p iii.

177 ACIL Allen, *Cost drivers of recent retail electricity prices for small NSW customers*, November 2018, p 15.

(ie, in 2017-18 and the start of 2018-19).[178] Figure 6.1 shows that this followed a substantial increase in prices last year.

Figure 6.1 Annual bills for NSW residential customers (nominal, GST-inclusive)



Note: ACCC bills have been estimated by smoothing data points between years for the years the bill data was not available.

Data source: Information from retailers, Energy Made Easy network price data, ACCC, *Restoring electricity affordability & Australia's competitive advantage,* June 2018.

Over the period since price deregulation, we estimate that average prices across NSW have increased by 4.1% or $73 since 2013-14, which represents a 4.5% or $88 reduction in prices in real terms (based on the consumption of 5,100 kWh for a typical customer). This is comparable with the ACCC's findings in Figure 6.1. It is also consistent with submissions received from two individuals who submitted that prices in NSW have remained relatively stable since price deregulation.[179]

Like the ACCC, we also considered how prices have changed over the last 10 years. There are some differences between our estimates and the ACCC's. For example, we calculated the annual bill for a typical consumer, holding consumption constant over time at 5,100 kWh per year, while the ACCC calculated its average annual bill by dividing total revenue by number

178 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.

179 One individual reported that the average price paid per in the year ended March 2018 was 26.5 c/kWh, which was the same as the average price for the year ended Sept 2013. Another submission found that for the last seven years, their bills had not changed as a result of falling energy consumption resulting from more energy efficient appliances. It reported that the rate per unit has gone up in the past two years from 22.86 cents per unit to 23.48 cents per kWh. Individual submission from O. Evans, October 2018, p 1; Individual submission from R. Aurora, October 2018, p 1.

of customers. Therefore, some of the ACCC's estimate of changes in bills reflect changes in average consumption – not only changes in price. For example, in 2007-08, the ACCC's average bill for NSW reflects consumption of around 7,000 kWh per year,[180] which is one of the reasons it is higher than our estimate.

We estimate that the NSW-wide average bill for a typical residential customer in NSW is currently around $1,857 (including GST), which is slightly higher than our estimate in our Draft Report of $1832.[181] This reflects changes to our assumptions for estimating the average bill. (Chapter 7 provides more detail on how prices have changed for different network areas, and for residential and business customers.)

To estimate this bill, we calculated the annual bill for a customer with average consumption for a range of different offers for each retailer (standing offer, most common, lowest, and other market offers). However, as Box 6.1 outlines, because we did not have information on the number of customers on every offer type, we had to make assumptions about the number of people on different offers. Between our Draft and Final Reports we have updated these assumptions based on submissions and information from retailers, and applied updated weightings to all previous years. In particular, these returns indicate that only around 1% of retailers' customers are on their lowest offer, whereas we previously assumed 10% were on this offer. However, retailers' most common offers tend to be quite close to their lowest offers, and we have assumed that 26% of their customers are on their most common offer.

In response to our Draft Report, Origin submitted our bill estimation methodology is imperfect, but appears to take a fair and reasonable approach to making a representation of the spread of offers in the market, and associated cost to consumers. It submitted that if a consistent methodology is applied over time, it is appropriate to provide a representative picture of the overall market.[182]

Origin Energy also submitted that our offer allocation does not represent its NSW customer base, as its most common offer is also one of its cheaper offers. Therefore it considered that the allocation of its customers to the mid-point between the standing offer and the lowest offer may result in an over-estimation of its customers' bill.[183] However, we consider that as our methodology also allocated 26% of Origin Energy's customers to it most common offer, we have addressed this concern.

We recognise that allocating customers to the midpoint of the standing offer and the lowest offer is a conservative assumption, which may result in a higher than average bill than is observed across the market. However, we consider that it is an appropriate assumption, given that:

- 30% of customers on market offers with conditional discounts don't meet their discount condition,[184] and end up paying standing offer prices. We have not adjusted for this elsewhere in our methodology.

180 IPART calculations from ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, pp 12-13.

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

182 Origin submission to IPART Draft Report, November 2018, p 3.

183 *Ibid.*

184 IPART calculations based on ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 29.

- We have potentially underestimated the number of customers on market offers with discounts that have expired. Our methodology allocates 22% of market customers to standing offer prices due to expired discounts based on AEMC findings.[185] However, we have received confidential information showing that it is likely to be higher than this for some retailers.

As a result of these allocations, we estimate that on average, market customers are paying 10% less that the standing offer (down from 12% in our Draft Report). This is closer the ACCC's offer distribution for NSW that implies that on average, market offer customers are paying 8% less than standing offers.[186]

185 AEMC, *2018 Retail Competition Review*, June 2018, p 62.
186 IPART calculations based on *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 15.

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 offers 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 assumptions about the number of people paying different prices. We based these off information from retailers for each different customer type (residential/business electricity/gas).

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 estimated annual bills by using the standing offer prices for the big three retailers (applying the NSW-wide retail market share to each network area). Given that less than 2%[a] of smaller retailers' electricity customers are on standing offers, we have not included their prices in our estimate of the average standing offers.
2. For customers on market offers, we allocated customers to either retailers' lowest offer, their most common offer, and to standing offer prices (to reflect the customers on market offers where the discount has expired[b]) as per Table 6.1. All remaining customers were allocated to a price point at the midpoint of the lowest offer and the standing offer (to reflect the range of other offers in the market).[c]

Table 6.1 Allocation of customers to offers

Price	Residential electricity	Business electricity	Residential gas	Business gas
Proportion of all customers on the lowest offer	1%	4%	2%	5%
Proportion of all customers on the most common offer	26%	15%	15%	18%
Proportion of market offer customers paying standing offer prices (for expired market offers)	22%	22%	24%	24%

The full value of any unconditional and conditional discounts has been applied to all offers.

To estimate the average residential bills across NSW, we 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). For gas country bills, all country distribution areas were weighted equally.

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 similar estimates of average bills.

a ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 141.

b IPART calculations based on AEMC, *2018 Retail Competition Review,* June 2018, pp 61-62.

c The offers of the big three retailers were weighted by their market share, and the remaining retailers were given an equal weighting.

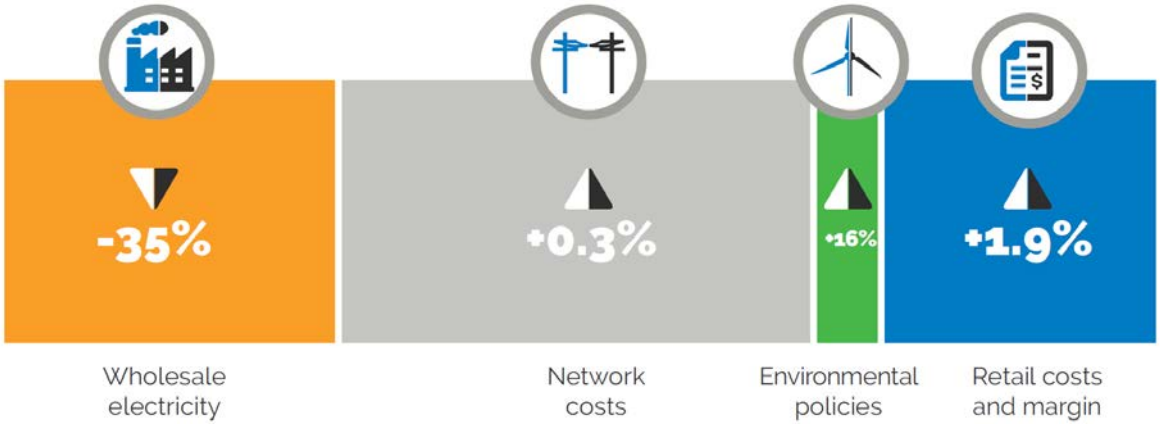
6.3 Underlying costs of supplying electricity fell into 2018-19

We engaged economic consultants ACIL Allen (ACIL) to examine the cost drivers (Box 6.2) behind the increases in retail electricity prices for 2017-18 into 2018-19. Based on its advice, we found that the overall costs of supply have fallen by around 10% using a point in time approach (depending on the customer type and approach).[187] As Figure 6.2 shows, this change in costs is due to:

- A significant decrease in forward wholesale prices (which made up around a third of the average electricity bill in 2017-18). These prices decreased by around 35% (when we look at the average forward prices in June 2017, compared to June 2018).[188]
- A slight increase in network costs across the three network areas in 2018-19 (which made up around 40% of the average residential electricity bill, and around 50% of the bill for business customers). These costs increased by 0.3% for residential customers, and 0.7% for business customers across NSW.[189]
- A 16% increase in green costs (which made up around 6% of the average electricity bill). This increase was mainly due to 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.[190]
- An estimated increase in retail costs in line with inflation (1.9%), given no strong evidence to suggest that retail costs changed substantially in 2018-19.[191]

187 ACIL Allen, *Cost drivers of recent retail electricity prices for small customers in NSW,* November 2018, p iii.
188 *Ibid*, pp 8, 13.
189 These estimate have been updated from 0.1% and 0.65% respectively between our Draft and Final Reports, reflecting updates to ACIL Allen's estimates due to including network metering costs in its final estimates. The change in network costs varied by network areas, decreasing by around 0.5% in the Ausgrid network, remaining relatively unchanged in the Endeavour network, and increasing by 2.4% in the Essential region. *Ibid*, pp 8, 22-23.
190 These estimates have been updated from 54% between our Draft and Final Reports, reflecting revisions to ACIL Allen's estimates due to calculation of the volume of certificates to be required as a result of timing differences. *Ibid*, pp 19-21.
191 This estimate has been updated from 1.8% between our Draft and Final Reports, reflecting an updated inflation index. *Ibid*, p 25.

Figure 6.2 Change in residential electricity costs in 2018-19



Note: Our estimates of the cost changes have been updated between our Draft and Final Reports. Network costs are based on change for residential customers.

Data source: ACIL Allen, *Cost drivers of recent retail electricity prices for small customers in NSW,* November 2018, pp 12, 16, 21, 23, 25.

Box 6.2 Customers' bills are made up of several 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 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.

6.3.1 Wholesale costs decreased by around 35%

To measure the change in wholesale costs, we looked at the change in forward contract prices on the ASX for a mix of contract types (baseload, swaps, and caps). Using a point-in-time approach, we found that wholesale costs have decreased by 34%, comparing the prices at 1 June 2017 to 1 June 2018, and 38%, comparing the 30-day average price to 1 June in each year.[192]

The fall in wholesale costs for 2018-19 reflects increased supply, as the Swanbank E gas power station was returned to service, and several renewable generation projects have recently come online.[193] However, they follow a substantial increase in wholesale costs in 2017-18 due to the retirement of a number of generators, including Munmorah, Wallerawang C, Redbank, Smithfield and Hazelwood. Since NSW is connected to the NEM, the closure of Hazelwood (a coal fired power station in Victoria) in particular, 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 – especially gas-fired plants – have been setting the market clearing price more often. At the same time, 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 6.2). When the change is measured using the average forward wholesale price over a two-year period, costs have increased by around 8.5%, compared to the large cost reductions under the other two methods.[194] However, 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.

Table 6.2 Comparison of cost changes in NSW using different measures, 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	-10.1%	-11.4%	8.5%
Small business customer	-9.3%	-10.5%	8.2%

Source: ACIL Allen, *Cost drivers of recent retail electricity prices for small NSW customers*, November 2018, pp iii, 15.

The load shape for customers is also 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,

192 ACIL Allen, *Cost drivers of recent retail electricity prices for small NSW customers*, November 2018, p 13.
193 *Ibid*, p 14.
194 ACIL Allen, *Cost drivers of recent retail electricity prices for small NSW customers*, November 2018, p iii.

we found that there is no strong evidence that suggests higher wholesale energy costs are driven by changes in load shape.[195]

6.3.2 Green scheme costs increased by around 16%

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

We found that these costs increased by around 16% into 2018-19.[196] This was made up of:

- An increase in the costs of complying with the Large-scale Renewable Energy Target (LRET) by around 15%. 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 acquire them through the spot market, placing upward pressure on LGC spot prices.[197]
- An increase in the costs of complying with the Small-scale Renewable Energy Scheme (SRES) by around 20%, driven by a substantial boom in the installed capacity of solar photovoltaic (PV) systems which lead to a surge in STC creation, compared to the forecast number of certificates. These additional certificates are required to be purchased by retailers.[198]

Our estimate of green scheme costs is significantly lower than the estimate in our Draft Report, which was 54%. This is mainly because in its Draft Report, ACIL Allen had used the volume of certificates required over the 2018 calendar year, rather than the 2017-18 financial year. This has been updated in its Final Report.[199]

ACIL Allen found that the change in the costs of complying with the NSW Energy Savings Scheme was negligible (less than 0.1%).[200]

195 ACIL Allen, *Cost drivers of recent retail electricity prices for small NSW customers*, November 2018, pp 9-10.
196 *Ibid,* p 21.
197 *Ibid,* p 20.
198 For the SRES scheme, each year the difference between the sum of STCs created in previous years and the sum of STCs surrendered in those years is calculated and used to adjust for disparities between the estimates made in previous years and the actual amounts. This cumulative adjustment aims to account for over- or under- supply of STCs in earlier years and aligns with the aim that all STCs are surrendered over time. By the end of 2017, 7.2 million more STCs had been created than liable entities were required surrender. Consequently, this amount was added to the amount of STCs estimated to be created in setting the 2018 STP. In ACIL Allen's updated estimate of the change in green costs, it used only half of this adjustment for the half year in 2017-18, rather than the full adjustment for 2018. This substantial reduced its estimate of the change in costs of complying with the SRES scheme from 120% to 20% in its Final Report. *Ibid*, pp 18-20.
199 *Ibid*, p 19.
200 *Ibid,* pp 20-21.

6.3.3 Retail costs increased in line with inflation

ACIL Allen found no strong evidence to suggest that the retail cost component of retail electricity prices in NSW had changed substantially into 2018-19. Therefore, it assumed that this cost increased it by 1.9% in line with inflation.[201]

In contrast, the ACCC found that in NSW the retail cost component increased from around 14% to 18%, **as a proportion of total costs** between 2013-14 and 2017-18 (See Figure 6.3).[202] It found that this increase was driven by a substantial increase in the retail margin, which more than offset a fall in retail operating costs.[203]

One of the main functions of a retailer is to manage fluctuating wholesale prices for customers. Wholesale prices change significantly across the day, and over different periods. In an environment of volatile wholesale costs, maintaining relatively stable prices is likely to result in retail margins that fluctuate from year to year. However, for the three years to 2017-18, the ACCC found retail margins in NSW were persistently high, averaging 10%.[204] In comparison, IPART set a regulated retail margin allowance of 5.7%[205] for 2013-14, the final year that we regulated prices. (Although the ACCC found that the retailers' actual margin in NSW was around 2.4% in that year.)[206]

As a proportion of revenue, at 10%, the ACCC's finding on the retail margin in NSW was higher in 2017-18 than the NEM-wide retail margin of 8%, but lower than the 11% retail margin in Victoria.[207]

Increasing retail margins do not necessarily suggest there is a problem with competition. The retail (or profit) margin represents the premium demanded by investors for allocating capital to the retail business, and accepting systematic risks associated with providing electricity retail services. Higher margins are consistent with the higher risks that energy retailers face due to the uncertainty about the regulatory and investment environment.

For example, the introduction of a default offer would create a risk to retailers of capped prices that do not reflect their costs. Sumo submitted the impact of a default tariff being introduced would be felt well before the default price was ever determined. As a new entrant retailer, it relies on tapping into capital markets to fund its growth, and the threat of price regulation makes investors nervous.[208]

In addition, volatile wholesale costs and the lower availability of low-risk hedging products are making it more difficult for smaller retailers to effectively manage their wholesale price risk (as discussed in Chapter 3). Large retailers are less exposed to this risk because they own substantial generation assets, which allows them to manage these costs. However, they are

201 *Ibid*, pp 24-25.
202 IPART calculations based on ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018.
203 *Ibid.*
204 IPART calculations based on ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 37.
205 IPART, *Review of regulated retail prices and charges for electricity from 1 July 2013 to 30 June 2016*, June 2013, p 89.
206 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 146.
207 *Ibid,* p 8.
208 Sumo submission to IPART Draft Report, November 2018, p 4.

exposed to other risks such as policy changes relating to carbon emissions (than can change the relative value of their generation output, depending on its carbon intensity) and wholesale market concentration rules that could result in divestiture of their generation assets.[209]

6.4 Changes in prices reflect changes in the underlying costs of supply

Although we found that prices remained steady while the costs of supply increased into 2018-19, we consider that average prices currently reflect the level of underlying costs. This is because retailers did not increase prices in line with increases in wholesale costs in 2017-18, but rather appear to have smoothed the impact of these cost increases on bills over a period longer than a single year.

In 2017-18, wholesale electricity costs were expected to increase by around 140% (from around $50/MWh to around $115/MWh),[210] but bills increased by only 13%[211] in this year. If retailers had passed the full extent of this increase through to retail prices in 2017-18, these retail prices would have increased by around 30%.[212]

Looking at the cumulative changes in wholesale costs across 2017-18 and 2018-19, we found that these costs increased by around 50%.[213] Over these two years, this likely added around 12% to the average costs of supply.[214] 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.

Figure 6.3 shows our best estimate of the costs of supplying electricity customers in NSW, after the impact of wholesale prices being smoothed across years.

209 Australian Government, Electricity price monitoring and response legislative framework consultation paper, October 2018, p 2.

210 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.

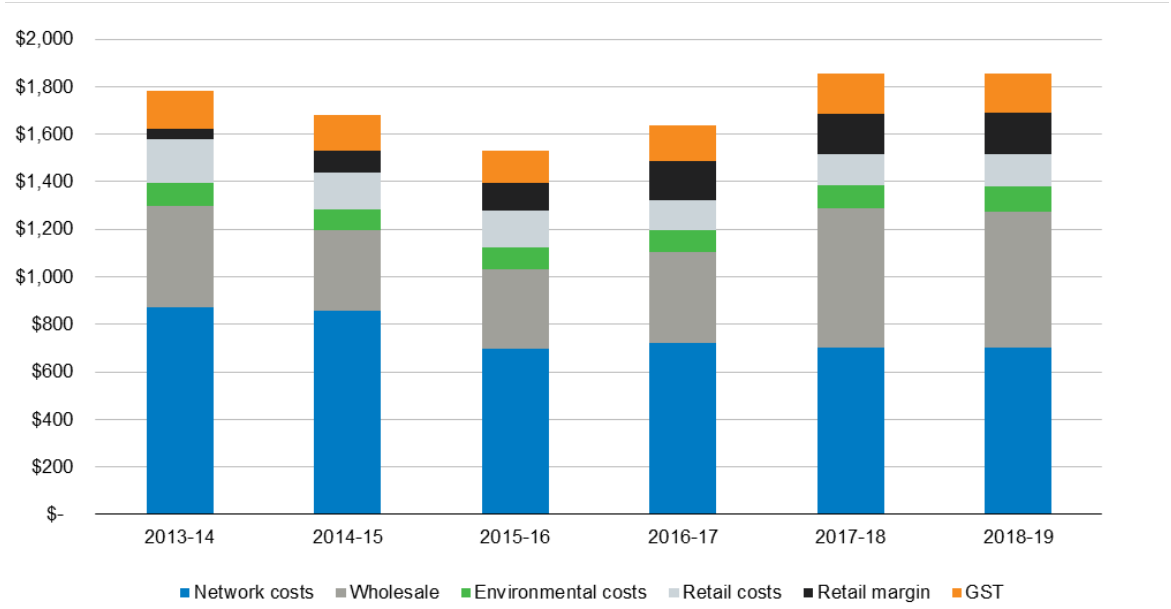
211 IPART calculations (reflecting updated offer weightings) based on data from retailers.

212 IPART calculations, based on Frontier Economics, *Cost drivers of recent retail electricity and gas prices for residential customers in NSW,* October 2017, p 36.

213 From around $50/MWh to around $75/MWh. Data from Thomson Reuters Eikon.

214 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 prices for small NSW customers*, November, 2018, pp iii, 12.

Figure 6.3 Costs of supplying electricity for a typical customer 2013-14 to 2018-19 (5,100 kWh pa, nominal, GST-inclusive)



Note: Based on our estimates of customers' bills, network prices, and the ACCC's and ACIL Allen's findings on retail costs and margins and green costs. Wholesale costs are a residual component, once the other costs have been subtracted from IPART's estimate of customer bills. Consistent with the ACCC's methodology, carbon costs have been factored into the wholesale cost component in 2013-14, rather than the green cost component. The network cost component includes network metering charges (we assume these apply to all customers).

Data source: ACCC, ACIL Allen, Network price lists.

6.5 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.[215] Because we do not consider that there is evidence that prices are higher than the underlying costs of supply, 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. We note the ACCC has specifically been asked to consider the profits being made by electricity generators and retailers and the factors that have contributed to these in its new market monitoring role.[216]

IPART 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 10% for 2018-19. This is mainly due to substantial reductions in forward wholesale prices of around 35% in 2018-19 (average forward prices in June 2017, compared to June 2018).

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

216 ACCC, *Electricity market monitoring 2018-2025,* 21 November 2018, https://www.accc.gov.au/regulated-infrastructure/energy/electricity-market-monitoring-2018-2025/discussion-paper, accessed 26 November 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 Price outcomes vary by network area

We are required to report on the differences in prices of electricity for small customers in regional areas. Electricity prices vary in different regions mainly due to different network costs of providing electricity services. These network costs make up around 40% to 50% of customers' electricity bills,[217] and are set by the AER.

This Chapter reports on the differences between regions for residential and business customers.

7.1 Overview of 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.[218] However, the price changes vary by network area.

Customers in regional areas pay more than those in metropolitan areas, however, their bills have fallen in nominal terms since prices were deregulated in 2013-14. This reflects large reductions in network costs in regional areas.

In the metropolitan networks, average prices for residential customers have increased by 8.5%, which is 0.5% reduction in prices in real terms (after adjusting for inflation).

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

Figure 7.1 shows residential bills by network area for a typical customer using 5,100 kWh per year. 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 $1,783, up from around $1,644 in 2013-14 before prices were deregulated. This is an increase of 8.5%, or a fall in real terms of 0.5%.[219]

In the Essential network area, the average bill for a typical customer is $2,063, down from $2,175 in 2013-14. This represents a price reduction of 5.2% since prices were deregulated, which is a 13.0%fall in prices in real terms.

---

217 ACIL Allen, *Cost Drivers of Recent Retail Electricity Prices for Small NSW Customers – Final Report*, 21 November 2018, p 8.

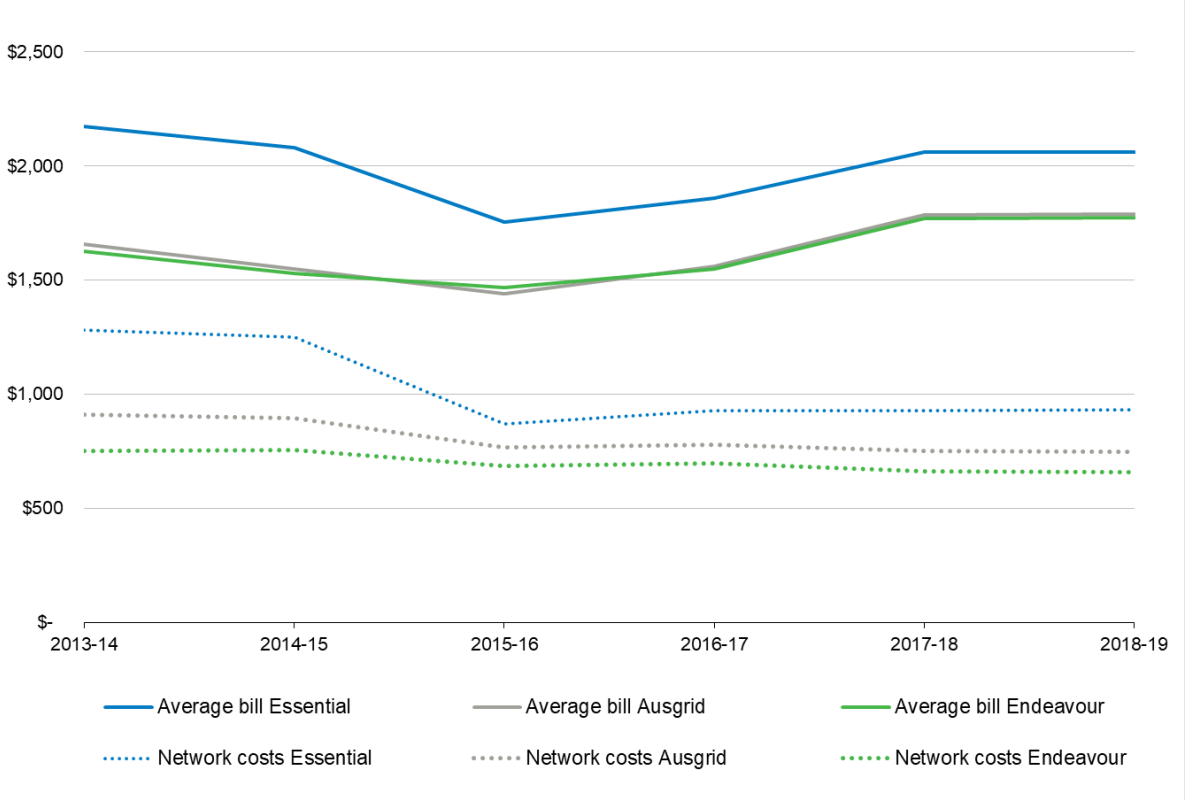
218 The average bill for NSW (across all network areas) has fallen by 4.5% in real terms.

219 In our Draft Report we reported the fall was around 9% in nominal terms or 1% in real terms - we have updated our assumptions on the proportion of customers on lowest market offers, most common offers, and standing offers to reflect updated information from retailers.

In each network area, standing offer prices have increased by more than the average prices in the market. In the Ausgrid and Endeavour regions, they have increased by 15% to 17% (a 6% to 7% increase in real terms), which is comparable with the ABS electricity price change index for Sydney (Box 7.1). In the Essential region they have remained flat (a 9% reduction in real terms).[220]

The main reason that bills are higher in the Essential region is because the costs of providing network services in the Essential region are around 31% higher than the metropolitan regions on a per household basis (down from 52% higher in 2013-14) (Figure 7.1). This is largely because the Essential Energy network covers a much larger geographical area (see Chapter 3), and also because the population density is much lower, so the network costs are recovered from a smaller number of customers.

Figure 7.1 Average household electricity bill and network costs for a typical residential customer by network area (5,100 kWh pa, nominal, GST-inclusive)



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

While customers in regional areas still pay more than customers in metropolitan regions, the difference between their bills has reduced over time (falling from 32% to 16% between 2013-14 and 2018-19). This is because there have been larger network cost reductions in the Essential

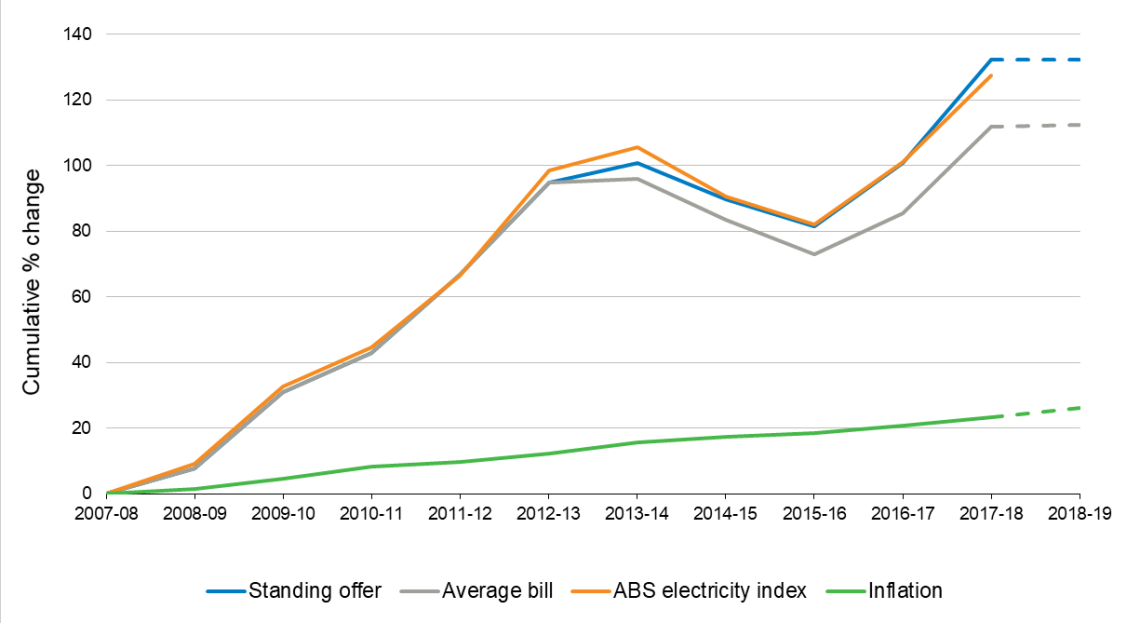
220 In our Draft Report we reported the fall was around 5% in nominal terms or 13% in real terms - we have updated our assumptions on the proportion of customers on lowest market offers, most common offers, and standing offers to reflect updated information from retailers

network, compared to Ausgrid and Endeavour. Figure 7.1 shows that in 2015-16,[221] network prices for residential customers fell by 9% (Endeavour), 14% (Ausgrid) and 30% (Essential).

Box 7.1 Our estimates of electricity price changes are consistent with the ABS

As part of its CPI calculation, the ABS measures the change in electricity prices for households each year through its electricity index for each capital city. When we estimate electricity bills for customers in the metropolitan area (based on the average bills in Ausgrid and Endeavour areas, which have parts of their network in Sydney), the changes in the standing offer prices track very closely with the ABS index. Figure 7.2 below shows that between 2007-08 and 2017-18 standing offer prices of the big three retailers increased by around 130%. When we take into account the range of offers in the market, the average bill for the metro region increased by just over 110% during this period.

Figure 7.2 Comparison of IPART price changes for metro customers with ABS CPI for electricity in Sydney



Data source: ABS Catalogue 6401.0, IPART calculations

221 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.

IPART finding

7 The average electricity bill increase for residential customers in metropolitan areas since price deregulation is 8.5%. This is a real decrease in prices of 0.5 % (once CPI is accounted for).

8 The average electricity bill decrease for residential customers in regional areas since price deregulation is 5.2%. This is a real decrease in prices of 13.0% (once CPI is accounted for).

7.3 Bills for small business customers vary with network area

Bills for business customers will vary significantly depending on the type of business they operate.[222] However, to compare outcomes across networks and offer types, we calculated the annual bill for small business customers consuming 10,000 kWh per year. For this level of consumption, business customers with the big three retailers are likely to pay between $3,000 and $5,000 in each year across the three network areas.

Figure 7.3 shows that similar to residential customers, business customers are likely to pay more for electricity in the Essential network. However, unlike residential customers, the bills for metropolitan customers are different between the Ausgrid and Endeavour networks, with Endeavour customers paying significantly less.

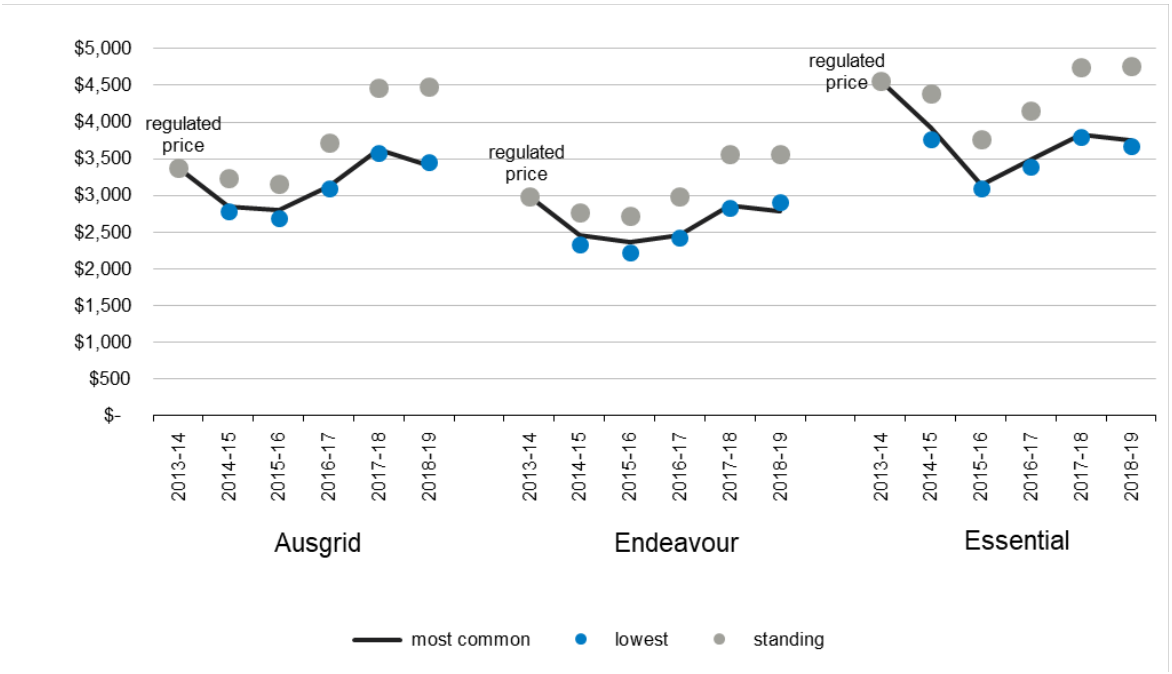
Based on the prices of the big three retailers, compared to the regulated price in 2013-14:

- Bills in the **Ausgrid** network for the most common offer are 1.1% higher in 2018-19, while standing offer prices have increased by 32.7%.
- Bills in the **Endeavour** network for the most common offer have fallen by 6.8% in 2018-19, while standing offer prices have increased by 19.1%.
- Bills in the **Essential** network for the most common offer have fallen by 17.9%, while customers on standing offers are only paying 4.2% more.

Figure 7.3 also shows the average most common offers in all three network areas have tracked very closely with the average lowest offers since prices were deregulated. In 2018-19, more customers in the Ausgrid and Endeavour network areas are on a cheaper offer than the lowest offers that are currently being advertised (by around $50- $110).

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

Figure 7.3 Average small business bills since 2013-14, (10,000 kWh pa, nominal, GST-inclusive)



Data source: Energy Made Easy, information provided by retailers, IPART calculations.

IPART finding

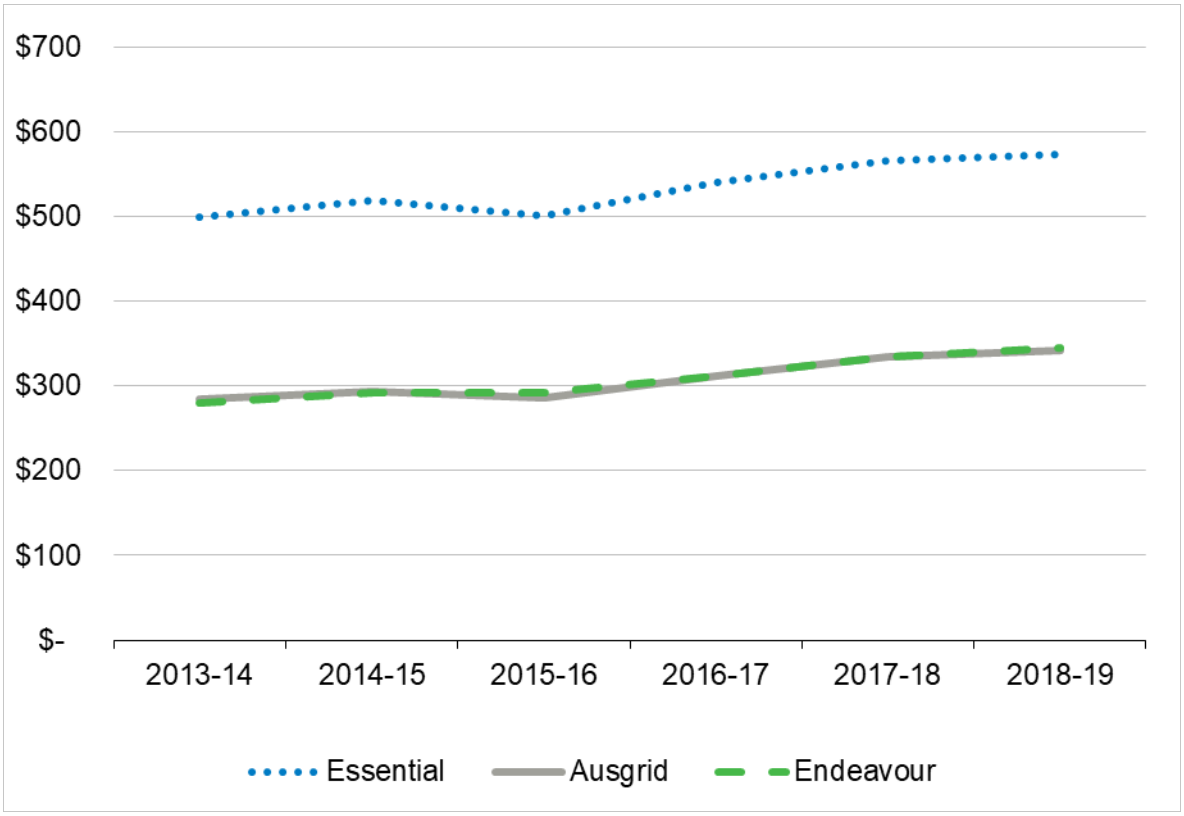
9 Since price deregulation, the bill for a typical Ausgrid small business customer has increased by 1.1% in nominal terms, and decreased by 6.8% and 17.9% in the Endeavour and Essential network respectively (comparing the most common offers currently in the market to the regulated prices in 2013-14). These are all price reductions in real terms.

7.4 The fixed portion of residential bills has increased over time

As well as looking at the change in the total bills for residential customers, we have also assessed the changes in the individual bill components in each network area.

Since 2013-14, for the average bill across all retailers, the fixed portion of residential customers' bills has increased by more than the overall increase. It has increased by 20% and 23% in the Ausgrid and Endeavour networks respectively, and 15% in the Essential Energy network, which is around $75 (Figure 7.4). Across all retailers, this increase is an average of $64. Unlike consumption charges, customers cannot reduce this portion of their bill by reducing their electricity usage.

Figure 7.4 Change in the average fixed bill component over time (residential customers, 5,100 kWh pa, nominal, GST-inclusive)



Data source: Energy Made Easy and information provided by retailers.

Retailers ultimately have discretion over how they recover their costs from retail tariffs, however we have considered whether higher fixed charges reflect the changes in fixed costs.

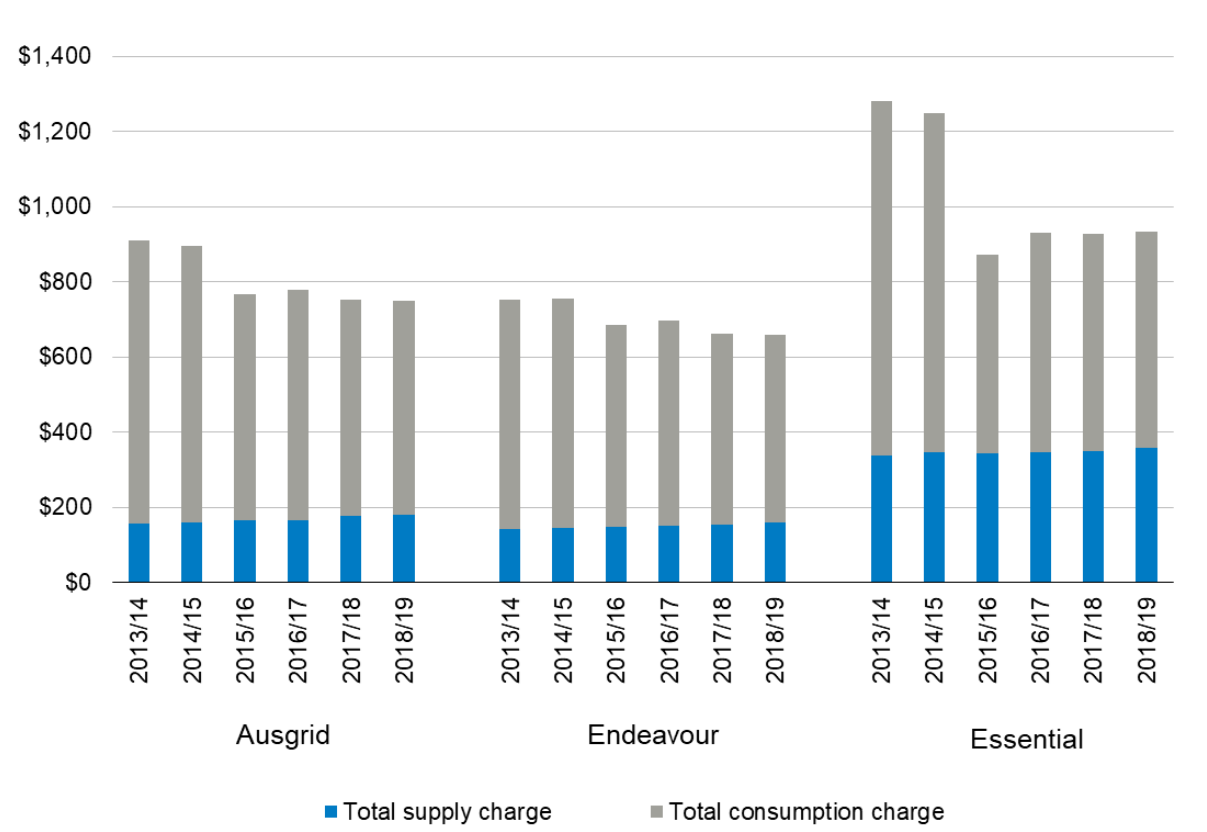
The main fixed cost components of residential customers' bills are a portion of the network costs, and retail costs. Around 24% to 38% of residential network charges are fixed, while almost all of the retail component is fixed (because billing and marketing costs are the same regardless of how much electricity a customer uses). The $64 increase in the fixed retail bill component can be partly explained by the change in the fixed network charges, which have increased by an average of $21, or 11% (Figure 7.5).[223]

Figure 7.5 also shows that the networks' consumption charges have reduced. A high proportion of the costs of providing network services are fixed, and so recovering more costs from fixed tariffs over time is likely to be consistent with National Energy Rule for tariffs to become more cost-reflective.[224]

223 In our Draft Report we found that fixed network charges had decreased by around 4% since 2013-14. However for our Final Report, we have updated the fixed network charges to reflect network metering service charges and the combination of these charges shows an increase in fixed costs. The networks' metering charges have been reported separately from their other charges since July 2015.

224 The new rule applies from July 2017. AEMC, *National Electricity Amendment (Distribution Network Pricing Arrangements) Rule 2014*, see pp i, 114, 144.

Figure 7.5 Change in residential network costs over time, by fixed and consumption charges (5,100 kWh pa, nominal, GST-inclusive)



Note: From July 2015 networks were required to report metering services charges separately from other network charges. Since our Draft Report, we have updated the network charges to include network metering service charges.

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.

Finding

10 The fixed proportion of residential customers' electricity bills has increased on average by 19% between 2013-14 and 2018-19, reflecting how retailers have chosen to recover their costs. This is a real increase in prices of 9% (once CPI is accounted for).

8 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 findings, and then discuss them in more detail.

8.1 Overview of findings

We have found 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 1.7%. In country areas, the average gas bill for country residential and small business customers decreased by 2.3% and 1.7% respectively.

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.[225] These have been driven by a 13% increase in wholesale costs due to tight supply-demand conditions in eastern Australia.[226] 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. We have found that the retail cost component in country areas is substantially higher than in coastal regions. However, the retail component in country areas has fallen this year, suggesting that competition is increasing and putting downward pressure on prices.

8.2 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.[227] We found that retail gas prices increased by 0.2% for residential customers and increased by 1.7% for small business customers between June 2018 and July 2018 (Table 8.1).

225 Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW- prepared for: IPART*, November 2018, pp 33-43.

226 *Ibid*, p 23.

227 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. For more information, see Box 6.1.

Table 8.1 Average gas coastal retail bills (GST-inclusive, nominal)

	June 2018	July 2018	% change
Residential coastal NSW	$863	$865	0.2%
Small business coastal NSW	$5,237	$5,327	1.7%

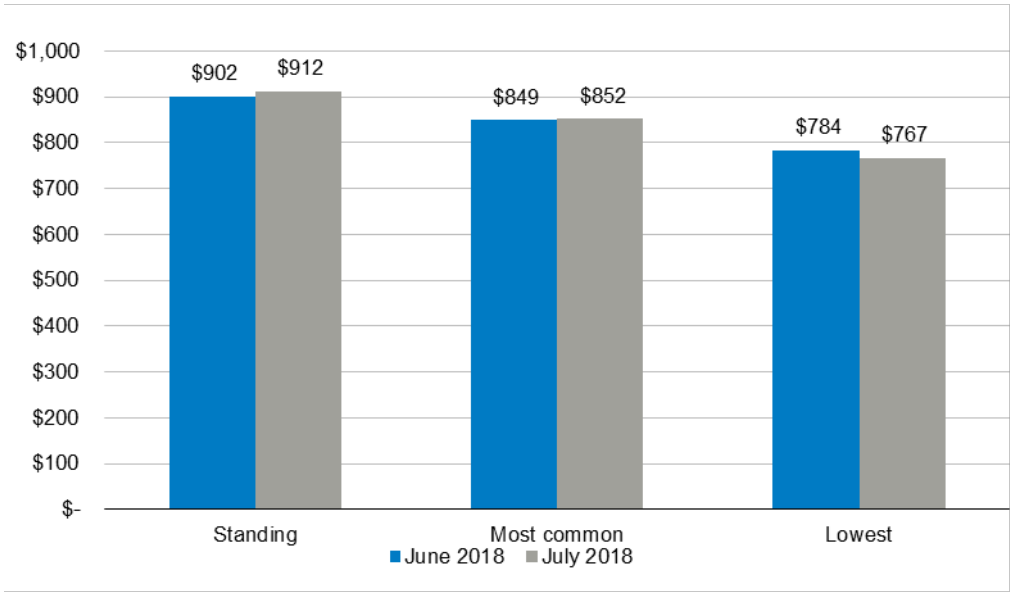
Note: Coastal NSW refers to the Jemena distribution area. We used annual consumption of 20 GJ for residential coastal customers and 184 GJ for small business customers. Weighted average annual bills are calculated as explained in Box 6.1. Retailers' market shares for coastal customers are from the AER's retail statistics and those for country customers are from IPART's household survey results for the Riverina area.

Data 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 1.2%. The most common offers were relatively unchanged, and the lowest offers decreased by 2.2% (Figure 8.1).

For small business customers, the most common offer increased by 0.7%, while the standing and the lowest offers increased by 1.9%.

Figure 8.1 Estimated annual gas bills for typical residential customers by offer type coastal NSW (20 GJ, nominal, GST-inclusive)



Note: Bills are calculated inclusive of all 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.

8.3 Country prices decreased between June 2018 and July 2018

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

Across these networks, we found that the average bill fell by 2.3% for residential customers and 1.7% for small business customers between June 2018 and July 2018 (Table 8.2).[228]

Table 8.2 Average gas country retail bills (GST-inclusive)

	June 2018	July 2018	% change
Residential country NSW	$1,299	$1,269	-2.3%
Small business country NSW	$6,146	$6,041	-1.7%

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 209 GJ 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 6.1. 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. The average across country networks is a simple average.

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 2.0% and 4.2% respectively, and the most common offer fell by 0.9% from June 2018 to July 2018 (Figure 8.2).

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%.[229]

For small business customers in country areas, the standing, most common and lowest offers decreased by between 1.5% and 3.1% from June 2018 to July 2018.

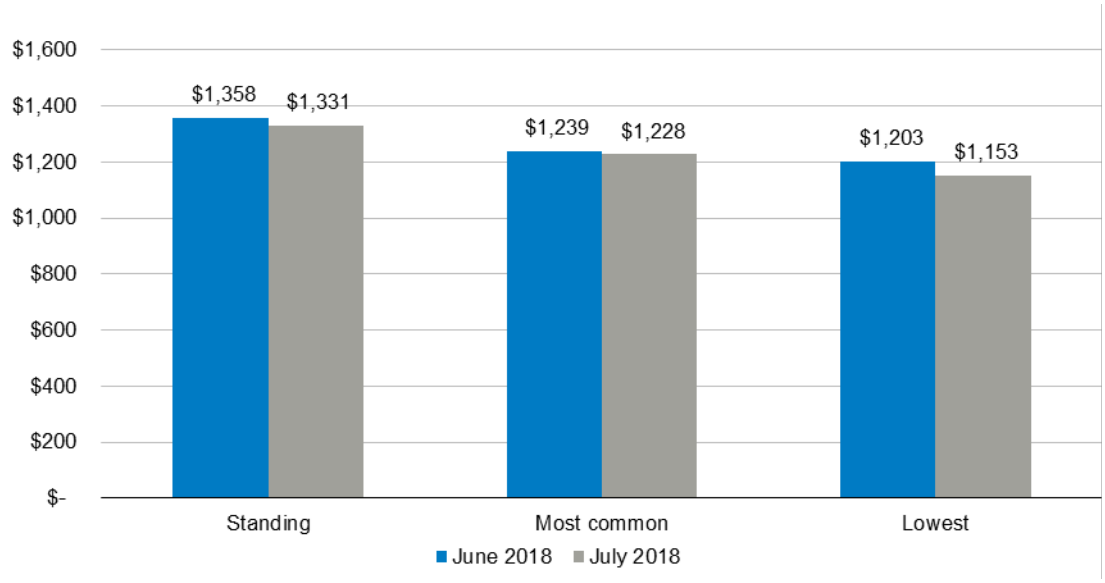
We note that our estimates of price changes differ from Oakley Greenwood's estimates because Oakley Greenwood's estimates are for market offers only.[230]

228 Based on a simple average across networks. 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.

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

230 Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW*, September 2018, p 7.

Figure 8.2 Estimated annual gas bills for typical residential customers by offer type in country NSW (41 GJ pa, nominal, GST-inclusive)



Note: Country refers to all NSW distribution zones, excluding Jemena. Bills are calculated 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.

8.3.1 Prices vary across country networks

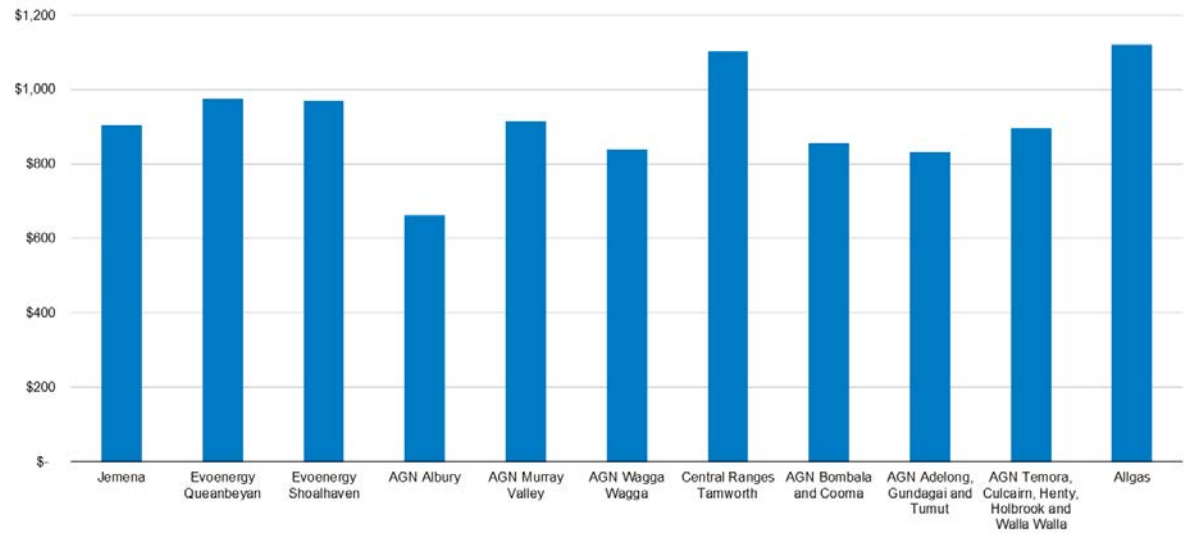
The estimated annual bills for country customers in Table 8.2 are higher than those for coastal customers due to the higher average annual consumption in country NSW. The higher consumption levels reflects greater demand for gas for space heating in country zones with cooler climates.[231]

Figure 8.3 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.[232] 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.

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

232 There are ten different distribution zones in country areas.

Figure 8.3 Residential gas bill estimates for average standing offers with 20 GJ consumption (nominal, GST-inclusive)



Data source: Energy Made Easy.

8.4 Gas costs have increased by between 2% and 6%

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
- **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 assess whether price changes reflected the change in efficient costs in a competitive market.

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.[233] This was primarily due to an increase in wholesale gas costs (see Figure 8.4 and Figure 8.5). 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.

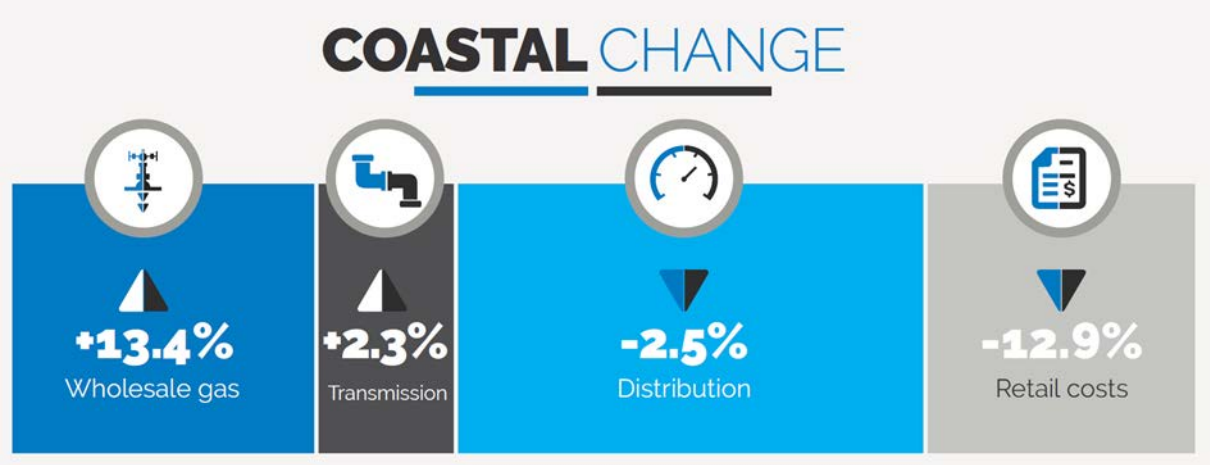
Oakley Greenwood has estimated the change in the retail component as the residual after subtracting the other costs from the total bill. Because the other costs have increased while the total bill has remained relatively flat, the retail component has fallen.

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

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.[234] Oakley Greenwood found that in some areas, prices are likely to be exceeding the costs of supply.[235] 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.

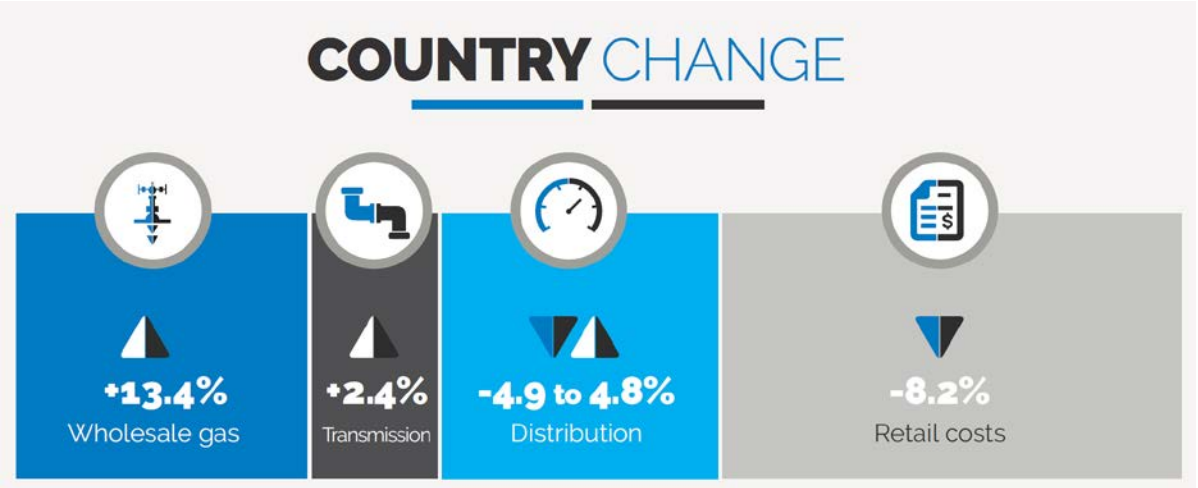
Figure 8.4 Changes in cost components of supplying gas to residential coastal customers



Note: Based on proportions of total bill for residential customers in 2017-18

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

Figure 8.5 Changes in cost components of supplying gas to country customers



234 *Ibid*, p 11.
235 *Ibid*, pp 51-62.

Note: Based on proportions of total bill for residential customers in 2017-18. A simple average has been used across networks.

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

8.4.1 Wholesale gas costs have increased

Origin submitted that falling wholesale gas costs have driven its recent 3% reduction in prices. It noted that the ACCC's gas monitoring reports found that gas prices peaked in early 2017.[236]

However, we found that wholesale costs in NSW have increased by 13.4% from 2017-18 to 2018-19.[237] 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 per GJ to $9.40 per GJ.[238]

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.[239]

8.4.2 Network costs

Network costs, which include the transmission and distribution costs, account for around 52% and around 38% 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 up to 4.8%. Transmission costs increased by around 2.5% for all customers.[240]

236 Origin submission to IPART Information Paper, August 2018, p 2.
237 Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW- prepared for: IPART*, November 2018, p 9.
238 *Ibid*, p 9.
239 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.
240 Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW*, November 2018, p 33.

8.4.3 Retail costs

Retail costs, which include retail operating costs and retail margins, account for 26% 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 (ie, the sum of retail operating costs and net margin) from the prices that are available in the market. Bills remained stable in 2018-19, while other costs increased by between 2% and 6%, which is 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.[241] For our Final Report, Oakley Greenwood expanded their analysis to include the Shoalhaven network area for country cost changes. While retail prices decreased in most country networks, prices increased by around 6% in the Shoalhaven network. As a result, this reduced the magnitude of the fall in retail costs for country customers from -10.6% to -8.2% between our Draft and Final Reports.[242]

8.4.4 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.[243]

In our previous review, we assessed whether gas prices reflected 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. As a result, we do not consider that a further 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.[244]

241 Oakley Greenwood, *Efficiency of Gas Prices for Small Customers in NSW*, November 2018, p36.
242 Based on a simple average across networks.
243 Section 234A(3)(g) of the National Energy Retail Law (NSW).
244 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.

Findings

11 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 customers and increased by 1.7% 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.

12 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.

9 Transitional measures to support competition are required

Overall, our findings on the performance and competitiveness of the NSW retail energy markets in 2017-18 and into 2018-19 indicate competition in these markets is continuing to develop and is delivering benefits to customers. However, we did identify some issues:

- The slow rate at which smaller retailers are gaining market share (discussed in Chapter 3)
- The difficulties some customers face in engaging in the market, particularly in comparing offers and identifying a 'good deal', which are limiting the extent that these customers from benefit from competition (Chapter 5), and
- The higher prices being paid by customers on standing offers (or who are on market offers paying standing offer prices) because they are not actively engaged in the market (Chapter 4).

As required as part of our energy Market Monitor role,[245] we have considered what, if any steps, are necessary to address these issues, and thus improve the competitiveness of the market. We have also considered the relevant issues raised in the Final Report of the ACCC's Retail Electricity Pricing Inquiry, as requested by the Minister. Specifically, we considered four possible options for addressing these issues:

1. Prohibiting retailers from engaging in aggressive retention and win-back strategies for a defined period to support competition
2. Introducing a non-binding reference (or benchmark) bill from which retailers must calculate their headline discounts to make it easier for consumers to compare market offers
3. Replacing standing offers with a regulated maximum "default offer", to reduce prices for disengaged customers
4. Making a regulated maximum "default offer" available to low-income customers only, to protect vulnerable customers who face additional barriers in engaging in the market from paying higher prices.

The sections below summarise our findings and recommendations on these options, and then discuss each option and our findings and analysis in detail.

9.1 Overview of findings and recommendations on measures to support competition

We maintain the view that workably effective competition – in combination with the consumer protections in the National Energy Rules and general consumer law – will result in the best outcomes for customers in the retail electricity and gas markets in the medium to long

245 Section 234A(3)(f) of the *National Energy Retail Law (NSW)*.

term. These markets are already subject to strong government oversight and non-price regulation to support competition and protect consumers while competition develops. Therefore, any further interventions by governments or regulators should **support** rather than hinder competition while it develops.

In line with this view, we found that a measure to limit retailers' retention and win-back activities should be adopted to support competition. Such a measure would help smaller retailers grow their customer base so they can compete more effectively over the longer term. This measure would also help by reducing the big three retailers ability to rely on retention and win-back strategies to keep these customers; it would put competitive pressure on the big three retailers to proactively offer their 'sticky' customers cheaper prices. We are recommending the NSW Government submit a rule change to the AEMC to prohibit retailers from engaging in retention and win-back activities for six months after a customer has switched retailers. We suggest that this rule should be in place for three years while the market continues to develop.

We also note that both the Australian Government and NSW Government have recently introduced a wide range of measures in a short space of time to ensure the market framework supports customer engagement. The more likely customers are to shop around, the more pressure there is on retailers to offer competitive prices and services, and the better the outcomes are for all customers. The measures outlined in Chapter 5 are designed to ensure that customers who want to shop around can do so effectively. We consider that they should be given time to work before further market intervention is contemplated.

In relation to the specific additional options we considered, we found that:

- A non-binding reference offer could assist customers to assess the value of different offers, without reducing levels of customer engagement or creating additional risks for retailers. However:
  - it is unnecessary at this time because other recently introduced measures are designed to provide similar assistance
  - there is a risk that calculating headline discounts against a reference offer would be misleading for customers with energy usage patterns that don't reflect the average energy user
  - it is likely to encourage retailers to continue structuring offers around the average customer's needs, so innovative tariff offers would be less likely to emerge.
- A regulated default offer would not support competition. While it would reduce prices for customers paying the highest prices in the short term, it would likely result in lower levels of competition over time, and thus higher prices in the longer term. In addition, it could not prevent retail energy prices rising in line with the underlying costs of supply increase.
- A regulated default tariff for low-income customers only could be useful to protect vulnerable customers who face additional barriers in engaging in the market. But it is not necessary to introduce this measure at this time. New measures to assist low-income customers have recently been implemented in NSW, and the evidence shows that they are improving outcomes for these customers.

We are mindful that continued regulatory change imposes costs on customers and taxpayers, as well as potential benefits. As Chapter 3 discussed, a piecemeal approach to policy and market rule changes increases the risks energy retailers face in doing business. In addition, the many state-specific changes to rules and regulations made across the NEM over the past few years add to retailers' costs in entering and operating in additional jurisdictions. Therefore, any additional measures should be introduced consistently across states and territories under the National Energy Customer Framework to minimise these costs.

9.2 New measure to limit retention and win-back activity by big three retailers necessary to support competition

Although the number of retailers competing in the NSW retail energy market is relatively large, many of these retailers have very small customer bases, and their total share of the market is increasing very slowly. As our Draft Report discussed, the ACCC found that a key impediment to smaller retailers expanding their customer bases is the aggressive customer retention and win-back practices of the large incumbent retailers.

In response, Origin Energy argued that retention activities are likely to be pro-competitive, and support strong price competition in the market.[246] However, PIAC and Sumo submitted that retention and win-back activity should be banned. PIAC said that while win-back offers provide an immediate benefit to the customer in question in the form of a cheaper energy contract, they result in less effective competition in the longer term.[247] PIAC[248] and Sumo[249] said that retention and win-back activity leads to higher bills for most customers, limits the ability of smaller retailers to grow their market share, and increases costs.

After considering these stakeholders' views and conducting further analysis, we concluded that retention and win-back activity is not in the long-term interests of consumers while the competition is still developing. This reflects our findings that:

- The big three electricity retailers have a particular financial advantage over new entrants that enables them to offer very cheap 'win-back' or retention offers to their customers who decide to switch retailers
- This makes it very difficult for smaller retailers to grow their customer share, and means the big three have little incentive to give long-standing customers a better price or service
- Prohibiting retailers from engaging in retention and win-back activities for six months after a customer switches would level the playing field for smaller retailers and thus support the development of competition
- Concerns about the effectiveness and risks of such a measure can be addressed through its design.

246 Origin submission to IPART Draft Report, November 2018, p 2.
247 PIAC submission to IPART Draft Report, November 2018, p 4.
248 PIAC also submitted that win-back marketing has the hallmarks of anticompetitive behaviour, as it is possible only because the incumbent retailer is privy to information that the customer has initiated a change of retailer – no other retailer has access to this information. *Ibid*.
249 Sumo submission to IPART Draft Report, November 2018, pp 1-2.

9.2.1 Incumbent electricity retailers have a particular financial advantage

It is common for incumbent businesses to have scale advantages over new entrants in markets across a range of industries. In particular, incumbent businesses often face lower costs on a per customer basis because they can recover more fixed costs from their existing customer base.

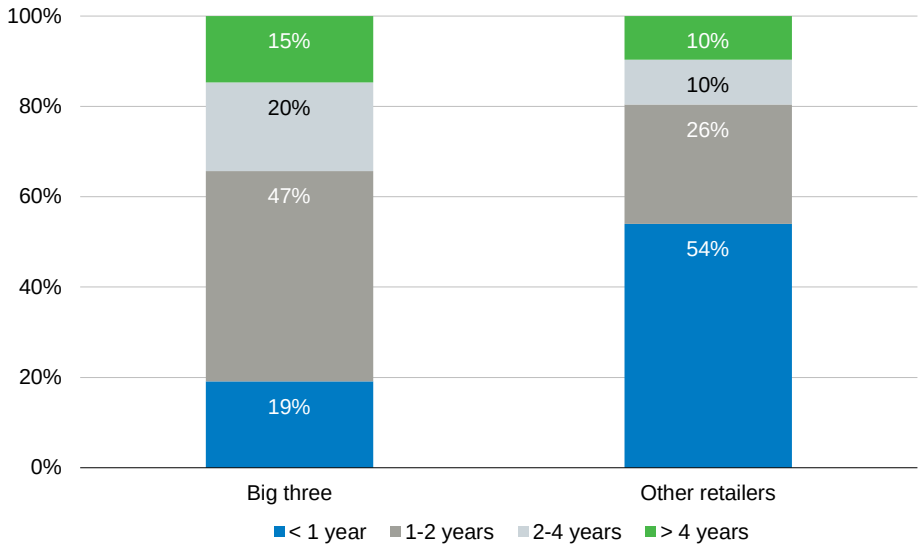
However, the big three electricity retailers have a greater advantage than incumbents in other industries. They are likely to have a much higher proportion of 'sticky customers' because they purchased a large proportion of their customers from government retailers, rather than 'winning' them. This means that some of these customers have never switched retailers and may be less likely to engage in the market in the future, because they have not engaged in the market previously.[250]

As a result, the big three retailers can charge these customers higher prices, and recover a greater proportion of their fixed and sunk costs from them. For example, the ACCC found that the average revenue per residential customer is almost $150 or 10% higher for the big three than for other retailers.[251] This enables them to offer very cheap win-back or retention offers to their customers who decide to switch retailers. The ACCC found that one of the big three retailer's retention offers were priced 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.[252] This gives incumbent retailers a particular price advantage for new customers that goes beyond normal scale advantages of incumbents.

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. Figure 9.1 shows that across the NEM, 81% of the customers of the big three retailers have been with them for more than one year, compared to only 46% for the other retailers.[253] Figure 9.2 shows that the big three retailers have a much higher proportion of their NSW customer base on standing offers (19% compared to 2% for smaller retailers), and an even greater proportion of their revenue comes from these customers (40% compared to 3%).[254] This advantage impedes small retailer growth, and means incumbents have little incentive to offer long-standing customers competitive deals.

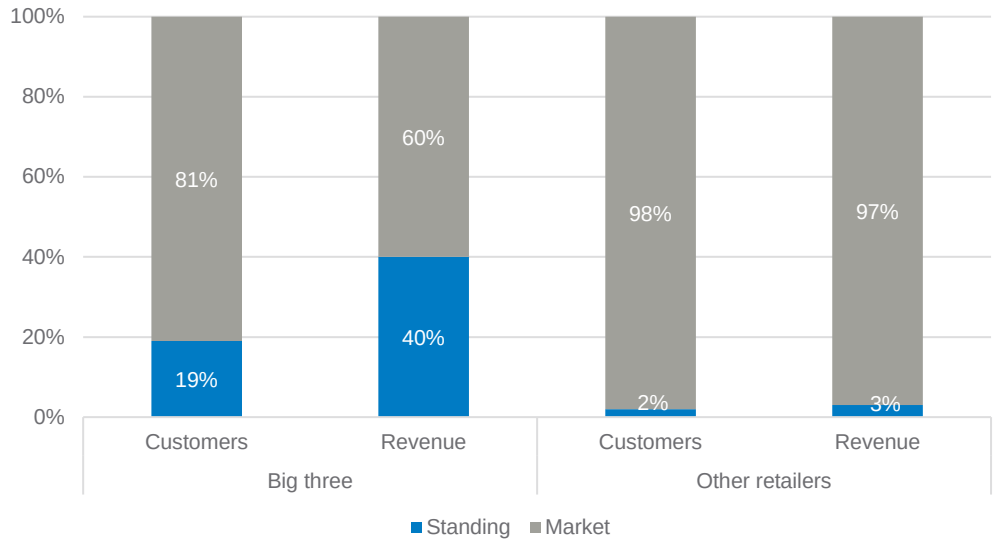
250 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 141.
251 *Ibid,* p 142.
252 *Ibid,* p 143.
253 IPART calculations based on ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 141.
254 *Ibid,* pp 141, 243.

Figure 9.1 Tenure of residential electricity customers by retailer type (NEM-wide)



Data source: IPART calculations based on ACCC, *Restoring electricity affordability & Australia's competitive advantage,* June 2018, p 141.

Figure 9.2 Residential customers and revenue for the big three versus other retailers by offer type (NSW)



Data source: ACCC, *Restoring electricity affordability & Australia's competitive advantage,* June 2018, pp 141, 243.

In addition, unlike in other industries, the incumbent retailer receives advance notice that a customer intends to change supplier. When an electricity customer signs up with a new retailer, that retailer lodges a 'change request' with AEMO to re-allocate the customer's electricity meter(s) to the new retailer. AEMO in turn sends a notification to the customer's

existing retailer informing them of the change request.[255] The incumbent retailer can use this information to 'save' the customer.

As Chapter 3 discussed, the ACCC has found that the incumbent retailers' use of aggressive retention and win-back strategies is a key impediment to smaller retailers expanding their market share. For example, it found that in 2016–17, Origin Energy's retention activities enabled it to retain 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. Several smaller retailers submitted to the ACCC that they lost around 20% of newly acquired customers to the incumbents' retention activities.[256]

Stakeholder submissions to our review support these findings. Sumo submitted that these activities 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. At the same time, the cost of customer retention for the incumbent retailer is relatively low, further exacerbating the differences in cost structures.[257] In addition, the ACCC 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.[258]

Further, as PIAC submitted, the ease with which the incumbents retain or win back a customer by making a short-lived retention offer means there is little incentive on these retailers to give their long-standing customers a better price or service.[259] The ACCC's findings that long-standing customers are likely to face higher prices supports this view.

9.2.2 Prohibiting retailers engaging in retention and win-back activities for six months after a customer switch should increase competition

We consider that in general, retention and win-back activity increases competition because it provides better outcomes for individual customers who decide to switch. It can provide customers with greater choice and the opportunity to achieve the best possible deal, putting downward pressure on prices.

However, this activity is not currently occurring on a level playing field in the NSW electricity market, which is hampering competition. Therefore, we consider that prohibiting retailers from engaging in this activity while competition is developing is likely to increase competition by:

- Creating an incentive for incumbent retailers to offer more competitive offers to the entire customer base, rather than rely on saves, due to an increased threat of a successful switch (ie they cannot rely on retention and win-back activity to keep the customer)

255 One reason for this process is to prevent fraudulent or erroneous transfers as it can enable these to be identified before a switch is completed. AEMO, MSATS Procedures – CATS Procedure Principles and Obligations, 1 December 2017, s. 3.4(a).
256 *Ibid,* p 142.
257 Sumo submission to IPART Draft Report, November 2018, pp 1-2.
258 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 142-143.
259 PIAC submission to IPART Draft Report, November 2018, p 4.

- Accelerating the growth in market share of the smaller retailers, increasing their capacity to compete as they expand (as their cost per customer falls), and they can avoid the costs of wasted marketing and acquisition activity from unsuccessful switches due to retention and win-back activity.

These impacts are likely to outweigh any impact of preventing lower counter offers from the losing retailers that further reduce customers' prices. The losing retailer's counter offer only needs to be marginally better than the new entrant to retain the customer, therefore the avoided savings to the customer are likely to be low. Anti-competitive impacts would be mitigated by allowing the losing retailer to contact the customer after a period of six months following the switch.

We also considered the risk that smaller retailers would offer new customers higher prices than they would otherwise if they had to anticipate a counter offer. We consider that this risk is low, because they would then risk losing the customer to a third retailer who is able to offer better prices.

9.2.3 Concerns about the effectiveness and risks of such a measure can be addressed through its design

When the ACCC considered this issue, it decided not to limit or prohibit retention or win-back activity. This was because:

- Similar restrictions that were introduced in New Zealand led to no overall increase in competition in the market
- It considered other actions could be taken in the market to help reduce retention activity
- It was concerned about unexpected and unintended consequences on the competitive dynamic in the market and regulatory complexity.[260]

In New Zealand, a ban was introduced to limit retention activity (where a retailer retains the customer before they switch), but did not place any restrictions on win-back activity where the retailer 'wins back' the customer after they have switched). Because the 'losing' retailers could also influence the time that a customer transferred to the new retailers, the New Zealand Electricity Authority found that the losing retailers adjusted to the new scheme by accelerating the transfer process, so that they could then contact the customer sooner for a win-back (which was permitted by the regime). As a result, the retailers replaced their retention activity with win-back activity, and there was no discernible increase in competition.[261]

The ACCC made two recommendations to limit the opportunity for losing retailers to conduct retention activity before a customer transfer has taken place (Box 9.1).[262] We agree that the current time for customer transfers is too long and that recommendations to shorten transfer times are appropriate. While these should help reduce customer retention activity, we consider that like the New Zealand experience, the impact of these measures is likely to be offset by increased win-back activity.

260 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 151.
261 New Zealand Electricity Authority, *Post implementation review of saves and winbacks*, Final Report, 29 August 2017, p 5.
262 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, pp 152 to 153.

We also consider that the risk of distorting the retail market by a targeted and well-designed retention and win-back prohibition for a limited time are low.

Box 9.1 The ACCC's proposals to reduce retention activity

The ACCC made two recommendations to reduce retention activity. Firstly, it 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.

The ACCC also recommended that the AEMC 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

Source: ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, pp 152-153.

Finding

13 The 'big three' electricity retailers have a particular financial advantage over new entrants that enables them to offer very cheap win-back or retention offers to their customers who decide to switch retailers. As a result they have little incentive to give their long-standing customers a better price or service.

Recommendation

1 The NSW Government submit a new transitional rule change to the AEMC to prohibit retailers from engaging in retention and win-back activities for six months following a switch. The proposed rule should be in place for a fixed transitional period (for example, three years) while competition continues to develop.

9.3 A non-binding reference tariff could assist customers but it is not warranted at this time nor without risks

In its pricing inquiry, the ACCC made a recommendation for standing offers to be replaced by a regulated maximum "default offer" to reduce bills for disengaged customers on very high standing offers (recommendation 30).[263] It also recommended that the AER publish a reference bill from which headline discounts can be calculated (recommendation 32).[264] The Australian Government has asked the AER to develop these instruments by 30 April 2019.[265]

A non-binding reference bill could provide customers with an additional tool for comparing market offers. The reference bill would be set for each network. All retailers would then

263 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 252.
264 *Ibid,* p 266.
265 AER, Retail electricity prices review - Determination of default market offer prices, https://www.aer.gov.au/retail-markets/retail-guidelines-reviews/retail-electricity-prices-review-determination-of-default-market-offer-prices, accessed 20 November 2018.

compare their offers to this reference bill. This would mean that all discounts would be comparable, making it easier for customers to compare offers and identify a 'good' deal. By making it easier for customers to engage in the market, it should increase competitive pressure on retailers.

9.3.1 Stakeholders generally supported a reference bill but questioned the need given other recent measures

Stakeholders who made submissions to this review generally supported a non-binding reference bill from which all retailers could calculate the discounts included in their market offers. For example:

- Origin Energy submitted that it could support a default reference price from which all retailers can discount, provided sufficient headroom was incorporated to enable true competition among retailers for the benefit of consumers.[266]
- AGL submitted a reference bill would make retailers' offers more comparable (for a given level of consumption). It suggested it would benefit, because currently its offers are among the most competitive, but its discounts are not the highest in the market as it has a relatively low standing offer.[267]
- The Australian Energy Council submitted that a non-binding reference bill would be far preferable to a default tariff but that more work needs to be done to ensure it would deliver the intended outcomes.[268]

However, stakeholders also submitted that before additional requirements such as a reference bill were introduced, the impacts of the changes already introduced in 2018-19 should be monitored.[269]

9.3.2 We agree a reference bill may be helpful it does not appear to be warranted at this time

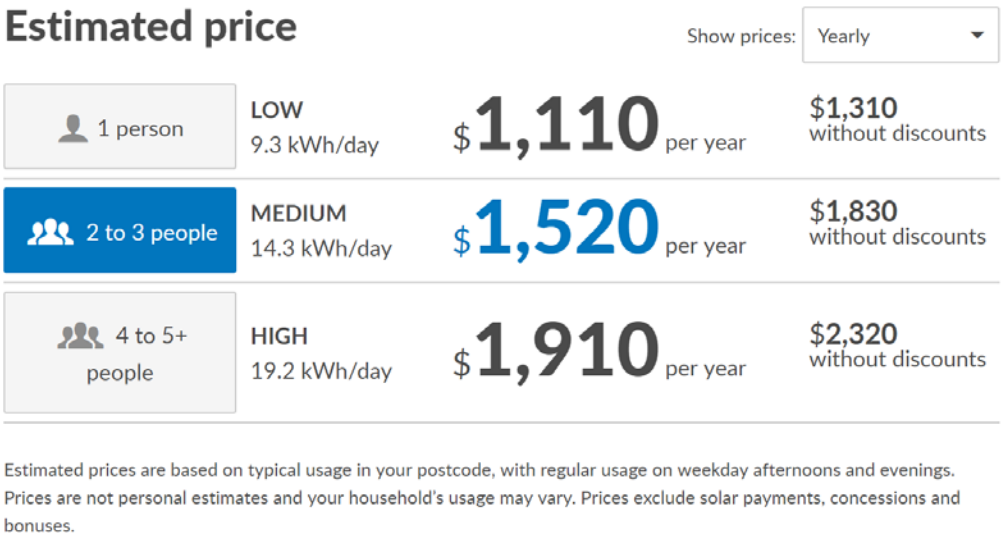
We agree with stakeholders that a reference bill could assist customers in engaging in the market by providing a consistent basis for them to compare retailers' market offers. As Chapter 4 discussed, retailers continue to use price discounts relative to their standing offer rate as the main way to attract customers. However, the headline discount they promote is not an effective way for customers to identify the best offer, because the underlying tariffs the discount is applied to vary. An offer that has no discount and low underlying tariffs could lead to a lower bill than one with a very high discount and high underlying tariffs.

We also agree with stakeholders that introducing a reference bill does not appear to be warranted at this time, given other recently introduced measures are designed to serve the same purpose. As Chapter 5 discussed, new requirements on how retailers present their offers

266 Origin submission to IPART Draft Report, November 2018, p 1.
267 AGL submission to IPART Draft Report, November 2018, p 2.
268 Australian Energy Council, submission to IPART Draft Report, November 2018, p 1-2.
269 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.

to customers commenced on 31 August 2018.[270] Retailers' 'basic plan information document' for each of their offers is now required to include an annual bill comparison table for a range of consumption levels so that customers can compare offers without having to make any calculations.[271] (See Figure 9.3 for an example.) Like the reference bill, these annual bill tables provide a consistent basis for comparing the different offers on the market.

Figure 9.3 Example of the annual bill comparison table on the basic plan document



Source: Energy Made Easy.

9.3.3 Our analysis indicates that setting the reference bill would not be straightforward nor without risk

We considered how a reference bill to help customers compare offers might work in practice. As noted above, the AER has been asked to develop the reference bill and is currently consulting on establishing this for the average consumption of residential consumers in each distribution zone. A retailer would calculate the annual bill amount for its offer using the same level of consumption, and then compare it to the reference bill to calculate the headline discount.[272]

This would make these offers easier to compare for customers using the average amount of electricity, or consumption profile. However, it could mean that the headline discounts for other different patterns of consumption compare poorly, even if these customers would be better off on these offers. Box 9.2 provides an example that illustrates this.

As Chapter 4 discussed, we found that in practice, there is a low level of market segmentation. This means that in general, retailers are not tailoring their offers to customers with a particular

270 AER, *Retail Pricing Information Guidelines 2018,* https://www.aer.gov.au/retail-markets/retail-pricing-information, accessed 26 September 2018.
271 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 109.
272 AER, *Position paper default market offer* price, November 2018, p 10.

consumption profile. As a result, currently the discount level would not vary much depending on the customer's individual circumstances.

However, as the take-up of smart meters increases, there are new opportunities for retailers to offer innovative tariff structures. We consider that the introduction of a reference bill would mean that these types of offers are less likely to emerge, and the structure of retailers' market offers will continue to converge around the average customer.

Box 9.2 Example of how headline discount can vary depending on assumed level of consumption

This example shows three offers that are tailored to different households: small, medium, and large. The highlighted cells in the table below show the best offers for each 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)		
	cents	c/kWh	**Low (3,000)**	**Typical (5,100)**	**High (9,000)**
Example reference rate	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

If retailers were required to calculate the headline discount using the consumption profile for the average customer (this example uses 5,100 kWh per year), 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%

9.4 Default tariff could lower prices for disengaged customers in short term but lead to higher prices for all in long term

The ACCC's pricing inquiry also recommended the introduction of a binding maximum "default offer" that would replace electricity retailers' standing offers. The Australian Government has asked the AER to develop this measure by 30 April 2019.[273] The intention of this measure would be to protect customers who are disengaged from the market from paying excessive prices.[274]

9.4.1 Stakeholders did not support a binding default tariff

Stakeholders submitted that a binding default tariff would discourage customer engagement in the market. For example, the Australian Energy Council said there is a genuine risk that introducing a default offer marketed as being a **fair** price for energy would encourage customers who otherwise would have switched onto a market offer to remain on the default tariff. This could result in the average energy bill being higher than it otherwise would be.[275]

The Australian Energy Council also said the international and local experience shows customers in price regulated jurisdictions are less engaged. In these jurisdictions, a significantly higher proportion of customers pay the higher regulated rates, and only the most price-sensitive engage in the market.[276]

Retailers also submitted that a binding default tariff would lead to higher prices and create a risk to retailers' viability:

- Origin said that it would create a risk of regulatory error (ie, of default tariff being set below retailers' actual costs of supply), and this would exacerbate price issues. In the short term, prices would need to reflect this risk. In the longer term, smaller retailers would reduce or withdraw their investment in the wholesale and retail markets (including in renewable generation and demand management, and possible new business models), leading to less competition and supply. It submitted that "in such an environment we are unlikely to see the investment in new energy generation needed to deliver truly sustainable lower prices."[277]
- Sumo said that a default tariff would impose "an unacceptable risk on retailers," particularly on stand-alone retailers with limited ability to absorb changes in wholesale costs.[278]

AGL also submitted that setting a regulated default tariff would be challenging because retailers have different business models in relation to managing their costs. It said that IPART's assessment of retail electricity and gas price changes and underlying costs for this review demonstrates that retailers employ different hedging and procurement practices. It

273 AER, Retail electricity prices review - Determination of default market offer prices, https://www.aer.gov.au/retail-markets/retail-guidelines-reviews/retail-electricity-prices-review-determination-of-default-market-offer-prices, accessed 20 November 2018.
274 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 249.
275 Australian Energy Council, submission to IPART Draft Report, November 2018, p 1.
276 For example, see KPMG, *Energy retail markets, An international review*, April 2017, pp 7-8.
277 Origin, submission to IPART Draft Report, November 2018, pp 4-5.
278 Sumo submission to IPART Draft Report, November 2018, p 4.

also said this assessment shows that a particular methodology, such as a point-in-time approach, may not fully explain changes in one year but could reflect changes in underlying costs over a longer period.[279]

Sumo submitted that the impact of this price regulation would be felt well before the default price was ever determined. It noted that as a new entrant retailer, it relies on tapping into capital markets to fund its growth, and the threat of price regulation makes investors nervous. This may mean some retailers will be unable to raise the capital required to fund future growth.[280]

9.4.2 We consider a default tariff would reduce customer engagement and lead to higher prices in the longer term

In the short term, the introduction of a regulated default tariff could help disengaged customers avoid paying excessive prices. However, as it would probably also reduce the benefits to customers of switching, it would decrease the number of active customers in the market.

For example, in its most recent survey of residential customers in 2017, the AEMC found that to consider switching retailer or plan, customers wanted to save an average of $364 per year on their electricity bill.[281] For a typical annual bill of $1,857, this represents a price reduction of more than a 20%, which is more than the current difference between standing offers and the cheapest offers in the market. This suggests that unless the default tariff was set substantially higher than the cheapest market offers, the incentive to actively engage in market would not be sufficient for many customers.

In the longer term, a smaller number of active customers in the market would likely lead to fewer retailers competing in the market. This is likely to lead to less vigorous competition and innovation and higher prices (Figure 9.4).

Figure 9.4 Impact of price regulation

Importantly, neither a binding default offer, nor a non-binding reference bill, would necessarily result in lower retail energy prices. If the underlying costs of supply were to increase, then both the default offer and reference bill would also increase. To illustrate, the

279 AGL submission to IPART Draft Report, November 2018, p 2.
280 Sumo submission to IPART Draft Report, November 2018, p 4.
281 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.

largest electricity price increases that occurred in NSW over a sustained period was between 2007-08 and 2013-14. Over this period, retail electricity prices were regulated. However, prices more than doubled, driven by large increases in regulated network costs.[282]

In 2013-14, retail electricity prices were deregulated. Since then, network costs (which make up around 40% of the bill) have fallen by 20%. However, these cost reductions have been offset by significant rises in wholesale electricity costs in 2016 and 2017.

This rise in wholesale costs was due to increasing gas costs and lower supply following the closure of Hazelwood power station. This suggests the most effective way to limit further prices increases 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. This means providing a stable and predictable investment environment.

In relation to network costs, we note that these costs are expected to continue to fall in real terms in the coming years. But more can be done to keep network prices as low as possible in the future. In particular, the main cause of the substantial increase in network costs and electricity bills over the period 2007-08 to 2013-14 was over-investment in the electricity distribution networks. To avoid similar over-investment in the future, governments should set distribution reliability standards using an economic framework that balances the cost of reliability of supply with the value that customers place on this reliability.

9.5 Default tariff for low-income customers could assist these customers but not warranted at this time

While we consider that a default tariff would lead to higher prices in the long term, we recognise that there are some low-income customers currently on high standing offers. These customers are paying significantly more than they would if they were engaged in the market and they are the least able to afford higher energy costs.

In its submission to our Draft Report, PIAC said that vulnerable consumers may have additional barriers to engagement or difficulties in comparing offers due to complex and confusing tariff structures. These additional barriers include being less numerically or financially literate, technological and/or language barriers, or having a disability, hardship plan or prepayment arrangement that limits their ability to change retailers. It considered that neither government nor retailer action improved customer engagement to any meaningful degree in 2017-18.[283]

PIAC also submitted that its research has found that in NSW those consumers who were disconnected by their retailer were likely to have multiple characteristics associated with social vulnerability, including unemployment, medical conditions and disability. It considered that if these consumers are not able to pay their bills to remain connected to energy, they will certainly not be able to effectively engage with the complex energy market to get a better deal.[284]

282 IPART, *Review of regulated retail prices and charges for electricity, From 1 July 2013 to 30 June 2016, June 2013*, p 18.
283 PIAC submission to IPART Draft Report, November 2018, p 3.
284 *Ibid*, p 3.

In light of this information, we considered whether a price cap should apply to low-income customers (such as, health care card holders) to protect them from higher prices. In our view, this kind of 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 only 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 these customers have only recently been implemented in NSW. In December 2017, the NSW Government introduced new obligations on retailers to help rebate customers move onto lower market offers.

There is evidence to suggest these changes are starting to improve market outcomes for these customers. In particular:

- The proportion of rebate customers on standing offers declined significantly over 2017-18
- Those rebate customers who are on market offers are paying less for energy than those still on standing offers for the same level of consumption
- When rebates are applied, they reduce rebate customers energy bills by around 18% on average.

As discussed in Chapter 5, in November 2018, the NSW Government also launched 'Energy Switch', to make it easier for customers to compare their current offer with the offers available. It identifies cheaper offers for customers, how much they would save, and provides an option to initiate a change of retailer. It is offered both online and at ServiceNSW centres.[285]

In addition, individual retailers are addressing affordability issues for vulnerable and standing offer customers on a national basis. AGL submitted that in August 2018, it announced it will cancel debt aged more than 12 months and offer dollar matching on debt repayments.[286] AGL and Red Energy also announced that they will be giving a 10% discount to their standing offer customers from 1 January 2019.[287] Similarly, EnergyAustralia announced that its eligible concession-card customers on standing offer tariffs would receive a 15% discount on their electricity and gas usage. This follows an announcement in August that EnergyAustralia's hardship customers on default tariffs would receive a rate equivalent to the company's best generally-available in-market offer.[288]

285 NSW Government, *'Energy Switch to save households hundreds of dollars*, November 2018, https://www.nsw.gov.au/your-government/the-premier/media-releases-from-the-premier/energy-switch-to-save-nsw-households-hundreds-of-dollars/, accessed 28 November 2018.

286 AGL submission to IPART Draft Report, November 2018, p 2.

287 AGL, *AGL announces safety net for electricity customers*, https://www.agl.com.au/about-agl/media-centre/asx-and-media-releases/2018/november/agl-announces-safety-net-for-electricity-customers, accessed 22 November 2018. Australian Financial Review, *Snowy Hydro to reduce standing offers as CEO slams 'stupid' rules,* https://www.afr.com/business/energy/electricity/snowy-hydro-to-reduce-standing-offers-as-ceo-slams-stupid-rules-20181129-h18j6d, accessed 30 November 2018.

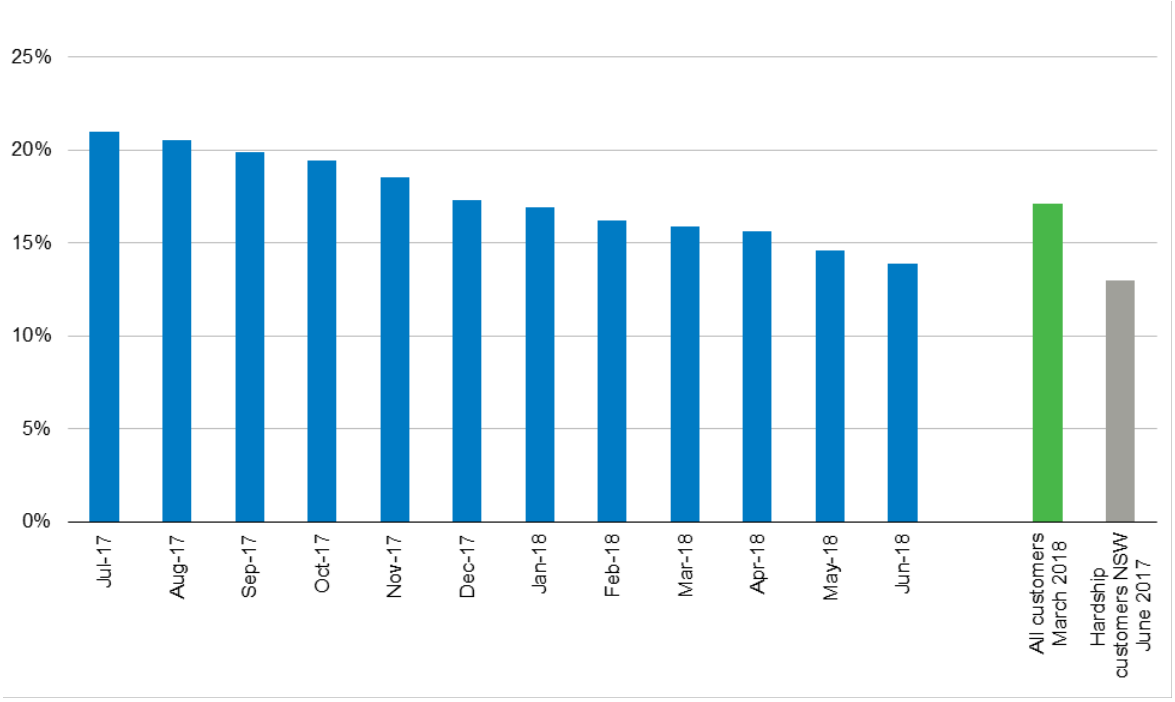
288 EnergyAustralia, *EnergyAustralia concession customers to receive automatic discounts*, November 2018, https://www.energyaustralia.com.au/about-us/media/news/energyaustralia-concession-customers-receive-automatic-discounts, accessed 29 November 2018.

9.5.1 Proportion of rebate customers on standing offers has declined significantly

Currently, around a third of all NSW customers, or 900,000 households receive at least one rebate on their energy bills. Since December 2017, 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 also required to report every six months 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.[289]

Data reported by retailers to the NSW Government shows the proportion of rebate customers on standing offers fell from 21% to 14% in 2017-18 (Figure 9.5). Retailer reporting showed over 50,000 customers switched from standing offers to market offers in 2017-18. The proportion of rebate customers on standing offers was lower than the state-wide average of 17% (as at March 2018). Similarly, the ACCC found that only 13% of customers on hardship and payment plans were on standing offers (as at June 2017).

Figure 9.5 Proportion of rebate customer on standing offers by month (NSW)



Data source: Data reported by Retailers to NSW Government, AER retail statistics, ACCC, p 245. We note that the AER information (all customers as at March 2018) may have some data errors relating to AGL customers and may be updated in the future. However we have reported this information because it is remains the best available data source.

289 NSW Social Programs for Energy Code, December 2017.

9.5.2 Rebates reduce the annual bills of receiving customers

Before rebates are applied, our analysis indicates that moving to market offers is resulting in lower energy bills for rebate customers in 2017-18:

- For electricity rebate customers, the average annual bill for those on standing offers was $1,713 (for an average level of consumption of 4,813 kWh per year). The average bill for those on market offers was only 1.5% lower, but their average level of annual consumption was 14% higher ($1,687 for 5,469 kWh per year). When we calculated the unit rates these rebate customers paid, those on market offers paid an average of 13% less per kWh than on standing offers.
- For gas rebate customers, the results were similar. Those on market offers paid unit rates for gas that were 5% lower than those paid by those on standing offers.

In addition, around a third of all customers in NSW, or 900,000 households, received at least one rebate in 2017-18 (Table 9.1). On average, these rebates reduced electricity bills for rebate customers by around 18% per year, and gas bills for rebate customers by around 15%. Households with a pensioner concession card or a health care card are eligible for a low-income household rebate of at least $285 per year.

Table 9.1 Rebates for residential energy customers in NSW (2017-18)

	Maximum rebate value	Number of customers
Low Income Household Rebate	$285	821,000
NSW Gas Rebate	$110	246,000
Family Energy Rebate	$180	43,000
Life Support Rebate	Varies	41,000
Medical Energy Rebate	$285	6,000
Energy Accounts Payment Assistance (EAPA) Scheme	$50 per voucher	54,000

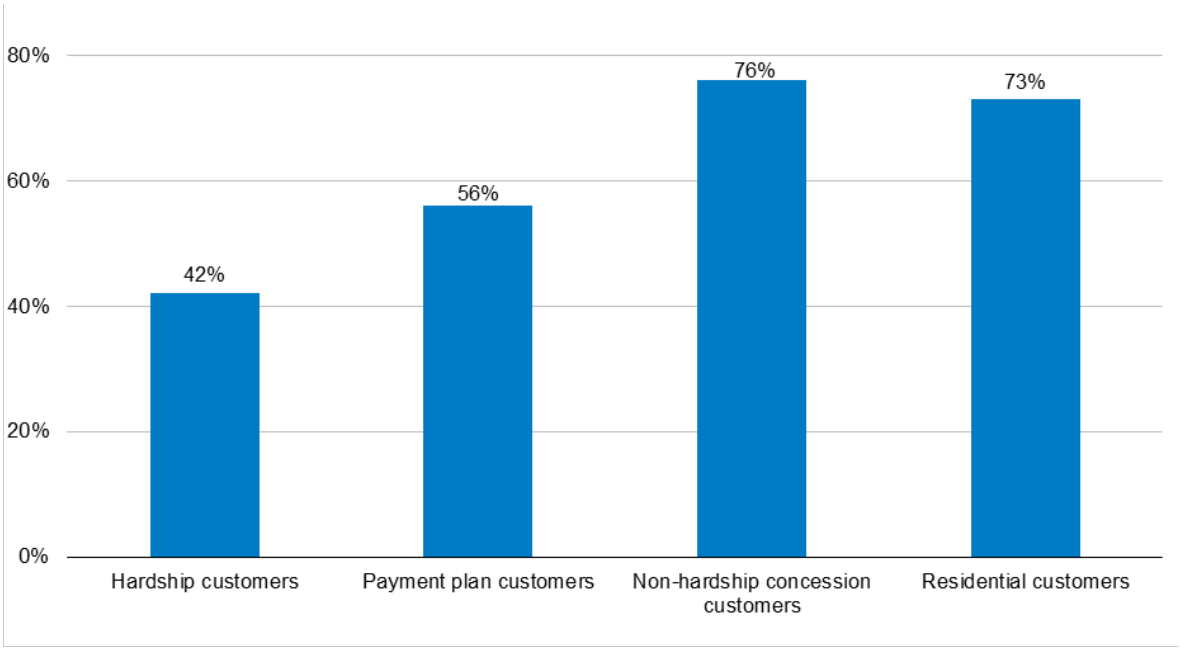
Source: NSW Government.

We note that residential customers in the Essential Energy network area were more likely to receive an electricity rebate than those in the other network areas. This area includes 31% of all rebate electricity customers in NSW, but only 24% of all NSW residential electricity customers. In addition, 41% of all electricity customers in the Essential Energy network area received a rebate, compared to 35% in the Endeavour Energy network area and 25% in the Ausgrid network area.

As Chapter 4 discussed, 57% of market offers require customers to meet a condition to receive the headline discount, like paying their bills on time.[290] In its pricing inquiry, the ACCC found that across the NEM, customers who are eligible for a concession card of some type are more likely to achieve their pay on-time discounts (76% of the time) compared to all customers (73% of the time). However, those on hardship or payment plans only achieve their pay on-time discounts around half the time (Figure 9.6).[291]

290 AEMC, *2018 Retail energy competition review*, Final Report, June 2018, p 54.
291 ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 29.

Figure 9.6 Proportion of the time customer groups achieve conditional discounts, residential non-solar (NEM-wide)



Data source: ACCC, *Restoring electricity affordability & Australia's competitive advantage*, June 2018, p 29.

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

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.

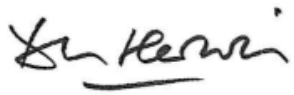
It is essential that the transition to the new arrangements is as smooth as possible to ensure ongoing consumer confidence in the market. I expect retailers to deliver high levels of customer service; however, I have heard reports of delays in meter installation and poor customer communication.

GPO Box 5341 Sydney NSW 2001 • P: (02) 8574 7200 • F: (02) 9338 5568 • E: office@harwin.minister.nsw.gov.au

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

C Data Tables

The data underlying charts used throughout this report is included in the tables below.

Table C.1 Average household bills by network area (weighted by offer type, 5,100 kWh pa, GST-inclusive)

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	Cumulative change	
	Nominal						Nominal	Real
Ausgrid	$1,657	$1,548	$1,439	$1,562	$1,785	$1,791	8.1%	-0.9%
Endeavour	$1,625	$1,528	$1,469	$1,549	$1,771	$1,773	9.1%	0.0%
Essential	$2,175	$2,079	$1,756	$1,861	$2,063	$2,063	-5.2%	-13.0%
Weighted average typical bill	$1,784	$1,681	$1,532	$1,636	$1,854	$1,857	4.1%	-4.5%

Source: Energy Made Easy and Information provided by retailers, IPART calculations.

Table C.2 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
	$3,568	Weighted average	$3,242	$3,004	$3,369	$3,921	$3,871

Note: Retailer's lowest offers are based on the lowest generally 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 may be lower than the lowest generally available offer.

Source: Energy Made Easy and Information provided by retailers, IPART calculations

Table C.3 Average residential 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	$767	$778	$752	$748	-$163	-17.9%
Endeavour	$752	$755	$685	$696	$661	$660	-$92	-12.2%
Essential	$1,281	$1,250	$871	$930	$927	$934	-$347	-27.1%
Weighted average	$958	$945	$769	$792	$769	$769	-$189	-19.7%

Source: Information from Ausgrid, Endeavour and Essential. Inclusive of network metering charges.