

# NERL REVIEW

*Issues Paper*

*Methodology for Review*

November 2013



## REQUEST FOR SUBMISSIONS

The Essential Services Commission of SA (**Commission**) invites written submissions from all members of the community in relation to the matters raised in this Issues Paper. Written comments should be provided by **Friday, 13 December 2013**. It is highly desirable for an electronic copy of the submission to accompany any written submission.

It is Commission's policy to make all submissions publicly available via its website ([www.escosa.sa.gov.au](http://www.escosa.sa.gov.au)), except where a submission either wholly or partly contains confidential or commercially sensitive information provided on a confidential basis and appropriate prior notice has been given.

The Commission may also exercise its discretion not to publish a submission based on length or content (for example, if it contains material that is defamatory, offensive or in breach of any law).

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The Essential Services Commission of South Australia is the independent economic regulator of the electricity, gas, ports, rail and water industries in South Australia. The Commission's primary objective is the *protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services*. For more information, please visit [www.escosa.sa.gov.au](http://www.escosa.sa.gov.au).

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## GLOSSARY OF TERMS

AEMC	Australian Energy Market Commission
AEMO	Australian Energy Market Operator
AER	Australian Energy Regulator
APR	Annual Performance Report. The Commission’s report on energy retailers’ performance for the period July to December 2012 was the Commission’s final APR on the overall performance of the energy retail market
Commission	Essential Services Commission of South Australia
ESC Act	<i>Essential Services Commission Act 2002 (SA)</i>
ESCV	Essential Services Commission of Victoria
Minister	Minister for Mineral Resources and Energy
Ministerial Pricing Report	The report required under Regulation 12 of the <i>Electricity (General) Regulations 2012</i> and Regulation 6 of the <i>Gas Regulations 2012</i>
NECF	National Energy Customer Framework
NEM	National Electricity Market
NERL	National Energy Retail Law, Schedule to the <i>National Energy Retail Law (South Australia) Act 2011</i>
NERL Review	The review of the operation of the NERL in South Australia, required under section 30 of the <i>National Energy Retail Law (South Australia) Act 2011</i>
NERR	National Energy Retail Rules, made in accordance with the NERL
RPM	Relative Price Movement

# 1. INTRODUCTION

## 1.1 Background

The Essential Services Commission of South Australia (**Commission**), established under the *Essential Services Commission Act 2002*<sup>1</sup> (**ESC Act**), is an independent economic regulator of essential services in South Australia. In undertaking its regulatory functions, the Commission's primary objective is the **protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services**.<sup>2</sup>

On 1 February 2013, the principal regulation of South Australia's retail energy market transferred to the Australian Energy Regulator (**AER**) with the introduction of the National Energy Customer Framework (**NECF**) in South Australia from that date. The AER is now responsible for consumer protection and performance monitoring in the electricity and gas retail market, including:

- ▲ regulating the retailer-customer relationship and associated rights, obligations and consumer protection measures for on-grid electricity and natural gas;
- ▲ regulating distributor (SA Power Networks and Envestra) interactions with customers and retailers, and associated rights, obligations and consumer protection measures;
- ▲ issuing retailer authorisations (replacing retail licences issued by the Commission) and issuing exemptions from the requirement to be authorised;
- ▲ monitoring, enforcing and reporting retailer compliance obligations;
- ▲ reporting on the performance of the energy market and retailer businesses; and
- ▲ administering an energy price comparison service.

Tasmania and the ACT commenced NECF on 1 July 2012, NSW commenced on 1 July 2013, with Victoria and Queensland yet to adopt NECF.<sup>3</sup>

The South Australian Government also announced in December 2012 its decision to remove regulated energy standing contract prices effective from 1 February 2013, which coincided with the adoption of NECF:

*“From 1 February [2013], a market-based system for determining electricity and gas prices will be introduced, underpinned by stronger consumer protection and improved hardship provisions as set out in the National Energy Customer Framework”.*<sup>4</sup>

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<sup>1</sup> Refer <http://www.legislation.sa.gov.au/LZ/C/A/Essential%20Services%20Commission%20Act%202002.aspx>.

<sup>2</sup> ESC Act 2002, section 6(a).

<sup>3</sup> The Standing Council on Energy and Resources (SCER) website advises that “Victoria will implement the NECF, subject to the resolution of state-specific issues. Queensland (QLD) aims to implement the NECF in 2014, subject to SCER agreeing to state-specific variations to support customers outside of south east QLD” (<http://www.scer.gov.au/workstreams/energy-market-reform/national-energy-customer-framework/>).

<sup>4</sup> Media release; available at [http://www.premier.sa.gov.au/images/news\\_releases/12\\_12Dec/energyprice.pdf](http://www.premier.sa.gov.au/images/news_releases/12_12Dec/energyprice.pdf).

The Commission's previous price regulation role (through setting electricity and gas standing contract prices) was replaced by a price monitoring and reporting regime administered by the Minister for Mineral Resources and Energy (**Minister**) informed by reports from the Commission, AER, the Australian Energy Market Operator (**AEMO**) and the Australian Energy Market Commission (**AEMC**) from time to time.

In the legislation establishing the operation of the National Energy Retail Law (**NERL**) in South Australia (which in turn establishes the NECF), the Commission was provided with two review functions:

- ▲ conduct a review of the operation of the NERL after 1 February 2015 (**NERL Review**); and
- ▲ reporting to the Minister on prices for the sale of energy available to a small customer under the NERL on an annual basis (**Ministerial Pricing Report**).

The Commission's first Ministerial Pricing Report was released in August 2013.<sup>5</sup>

The requirements on the Commission in undertaking the NERL Review are as follows:

#### *30—Review*

- (1) *The Commission must conduct a review of the operation of the National Energy Retail Law in South Australia after the expiry of 2 years from the date fixed under section 4.*
- (2) *The review must focus on the impact of the National Energy Retail Law on consumers of energy and whether the implementation of the Law has—*
  - (a) *resulted in increased efficiencies; or*
  - (b) *adversely affected customer protection in pursuit of national consistency, and may address such other matters as the Commission thinks fit.*
- (3) *The Commission must prepare a report on the outcome of the review and provide a copy of the report to the Minister.*
- (4) *The Minister must, within 6 sitting days after receiving a report under subsection (3), have copies of the report laid before both Houses of Parliament.*<sup>6</sup>

## **1.2 Review process & consultation**

The legislation provides the Commission with discretion in setting a date for reporting on the NERL Review; the only statutory requirement is that the review commence no sooner than 1 February 2015 – i.e., after two years following commencement of the NERL, which occurred on 1 February 2013.

The Commission's objective in releasing this Issues Paper at this time is to provide all members of the community with the opportunity to provide input on any issues related to the approach that the Commission proposes to adopt in conducting the NERL Review. This will help the Commission confirm a clear methodology, set a baseline for the review and

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<sup>5</sup> Essential Services Commission of South Australia, *Energy Retail Prices in South Australia-Ministerial Pricing Report 2013*, August 2013; available at <http://www.escosa.sa.gov.au/article/newsdetail.aspx?p=16&id=1183>.

<sup>6</sup> Section 30, *National Energy Retail Law (South Australia) Act 2011*.

ensure that key factors will be monitored in the period leading up to the review. Consequently, a key aspect of this process is to alert members of the community to potential data reporting requirements and to commence collecting this data for the NERL Review.

The Commission is not proposing to commence the NERL Review early and, in accordance with the legislative requirements, the Commission will not commence the review until after 1 February 2015. However, it is important that:

- ▲ the NERL Review be conducted in a timely manner, which will be assisted by consulting on the approach before commencement; and
- ▲ when the Commission commences the NERL Review it has access to critical data, which might be lost should the Commission wait to specify its data requirements until 2015.

The Commission proposes to publish a final NERL Review methodology in February 2014, following consideration of submissions to this Issues Paper.

The legislative requirement to undertake the NERL Review provides the Commission with sufficient powers to undertake functions necessary to perform the task prior to the time from which the review can be undertaken (i.e. in the lead up to 1 February 2015).

The Commission is proposing to report on the results of the NERL Review by Draft Report in October 2015 and Final Report in February 2016.

As will be outlined in this Issues Paper, the Commission considers the assessment of a range of indicators, based on public and non-public (i.e. held by retailers) data, as integral to undertaking the NERL Review.

The Commission encourages all members of the community to comment on the issues raised in this paper.

## 2. COVERAGE

As outlined in Section 1 of this paper, the NERL Review must focus on the impact of the NERL on South Australian energy consumers and whether the implementation of the NERL has—

- (a) resulted in increased efficiencies; or
- (b) adversely affected customer protection in pursuit of national consistency,

and may address such other matters as the Commission thinks fit.

The requirement in section 30(1) of the National Energy Retail Law (South Australia) Act 2011 that the Commission conduct a review of the operation of the NERL suggests that the Commission must also make a finding as to whether overall the operation of the NERL has furthered the interests of South Australian energy consumers.

Given the Commission's primary objective of the *protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services*, the Commission intends addressing the specific NERL Review requirements by first seeking to determine if there is any indication that the NERL has *adversely affected customer protection in pursuit of national consistency*.

The Commission will also attempt to determine whether the NERL has resulted in increased efficiencies, quantifying the impact to the extent possible. For reasons outlined below, the Commission proposes to adopt a broad economic interpretation of the term 'efficiency'.

The performance of the customer protection regulatory framework needs to be assessed within the context of the market it operates within. As noted, the retail energy market also changed on 1 February 2013 with the deregulation of energy retail prices. As a result, the Commission proposes to review the competitiveness of the retail energy market for the 2015 NERL Review, to assess how well the NECF customer protections operate within a competitive market, as well as assisting it to address those items identified in the legislated terms of reference.<sup>7</sup> These terms of reference permit the Commission to address such other matters as the Commission thinks fit.

A review of pricing outcomes is integral to the NERL Review as an explanatory variable. For example, if there was an increase in the number of hardship customers and disconnections during a period of price decreases then it may raise concerns about the customer protection framework, other things being equal, but an increase in hardship customers in the absence of pricing information would be harder to interpret. In this case it would be important to understand the prices faced by all customers.

Prices are also important in assessing the effective competitiveness of the South Australian energy retail market, as a means of determining the extent to which allocative efficiency has been achieved. Competition is not an end in itself but, where effective, is most likely to deliver prices that are in the long term interests of consumers.

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<sup>7</sup> Given NECF commencement and price deregulation commenced on the same date, it may not always be clear which of these actions has driven a particular observable outcome.



In preparation for the review it is necessary for the Commission to identify and collect baseline data it will need to enable it to draw conclusions on matters relevant to the NERL Review. While the baseline data set will as far as possible be drawn from publicly available data, it will be important to establish arrangements now regarding how non-public data will be collected and reported. The final detailed data requirements will depend on methodology matters to be addressed in the review, as discussed in the following sections.

## 2.1 *Customer protection*

The NERL, and associated National Energy Retail Rules (**NERR**), broadly reflect the protections contained in the previously operating customer protection framework established by the Commission (e.g. Energy Retail Code, Energy Marketing Code, Energy Customer Transfer and Consent Code, Energy Price Disclosure Code and the Energy Prepayment Meter System Code).

Therefore it is expected that the NECF should contain consumer protections at least equal to those applying pre-NECF. Nevertheless, a component of the NERL Review will involve an examination of the extent to which the NERL provisions reflect the pre-NECF South Australian energy customer protection framework. This will assist in determining whether any adverse impacts identified are driven by the approach adopted by relevant parties (e.g., retailers and/or the AER) rather than legislative intent. For avoidance of doubt, the Commission will review the operation of both the NERL and its associated statutory instruments.

An important aspect of the NERL Review will be to assess the nature of the interaction between customers and retailers and, in turn, both parties with the AER. A task for the review will be to identify any adverse outcomes from this new interaction, compared to these parties dealing with a local regulator (i.e., the Commission).

It is not considered necessary to separate out (normalise for) any adverse outcomes from ad hoc issues such as the implementation of a new billing system that might occur during the period of the NERL Review, as such issues have impacted the pre-NECF period and the expectation is that having a common customer protection framework should reduce the instances of such issues.

The Commission intends to rely on using its time series of customer protection metrics as a base from which to discern broad trends in consumer protection outcomes. For example, any evidence of a 'step up' change in the level of disconnections and number of hardship customers (per 100 customers) in the period after February 2013 would warrant close examination. Post-NECF, the metric used will be the one that most closely matches that previously collected by the Commission.

There are differences in the metrics being collected by the AER and those previously collected by the Commission. However, the following core set of metrics, based on information already being collected by the AER, is proposed that should enable a time series of data covering both pre-NECF and the NERL Review period:

- ▲ telephone and written performance;
- ▲ complaints (separate electricity & gas);
- ▲ hardship program customers (residential customers only, separate electricity & gas);
- ▲ concession recipients;
- ▲ disconnection for non-payment (separate electricity & gas, residential & small business);
- ▲ reconnection in same name (separate electricity & gas, residential & small business);
- ▲ instalment plans;
- ▲ customer numbers (by retailer); and
- ▲ security deposits (separate electricity & gas, residential & small business).

Other sources of data previously relied upon will also be considered, such as the number of customer complaints to the Energy and Water Ombudsman SA.

Given that the NECF is a protection framework for small customers, it is intended to confine the NERL Review to assessing the impact of the operation of the NERL on small customers only.<sup>8</sup>

In practice, it is only feasible in a quantitative sense to determine if customer protection has deteriorated or not under NECF by comparing performance in metrics under NECF with performance prior to NECF. Where the AER reports a broader range of hardship metrics, there will be no pre-NECF performance against which to compare for these additional metrics.

It will be more difficult to make qualitative assessments in the NERL Review, such as the extent to which customers consider dealings with retailers have improved; although in that case an examination of trends in complaints to retailers and ombudsman will assist.

Whilst it might be suggested that a customer survey could identify the extent to which customers consider the level of protection has improved or not under the NERL, it is not the Commission's starting position that such a survey would be useful for the purposes of the NERL Review given that:

- ▲ no base survey was conducted prior to the transfer to NECF; and
- ▲ the review will be conducted more than two years following the transfer, which may question the reliability of customer recall of the pre-NECF situation.

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<sup>8</sup> Under the legislation establishing NECF for South Australia, small customers are defined as those consuming less than 160MWh (electricity) and 1 TJ (gas).

Nevertheless, customers will be encouraged to make submissions which may raise issues with the operation of the NERL at that time. If so, the Commission may need to determine the extent to which pre-NECF transfer customer protections may, or may not, have resulted in a preferred outcome for the customer.

One potential adverse outcome of a standardised national framework could be a loss of innovation to deal with specific South Australian issues. The extent to which this may be occurring may be discernible from submissions closer to the NERL Review reporting time.

**Question 1:**

**Are the following proposed metrics supported to form the basis of a quantitative assessment of customer protections under NECF?:**

- telephone and written performance;**
- complaints (including complaints to the Energy & Water Ombudsman);**
- hardship program customers;**
- concession recipients;**
- disconnections;**
- reconnections;**
- instalment plans; and**
- security deposits.**

**Question 2:**

**Are there any other considerations the Commission should have regard to in making an assessment on whether the implementation of the NERL has adversely affected customer protection?**

## 2.2 *Increased efficiencies*

In considering the NERL Review's 'increased efficiencies' term of reference the Commission proposes to adopt the broad economic use of the term 'efficiency', covering:<sup>9</sup>

- ▲ Productive efficiency which incorporates technical efficiency, requiring that goods and services be produced at lowest possible cost:
  - in the context of this Review would cover questions such as whether electricity prices have reduced relative to retailer operating costs;
- ▲ Allocative efficiency relates to ensuring the community receives greatest return from its scarce resources:

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<sup>9</sup> Productivity Commission, *On Efficiency and Effectiveness: Some Definitions*, Staff Research Note, May 2013, Canberra, for a discussion on meaning of the term 'economic efficiency'.

- in the context of this Review would cover questions as to whether the energy retail market is competitive; and
- ▲ Dynamic efficiency covers the allocation of resources over time:
  - in the context of this Review would cover questions such as the extent of innovation occurring in market contract offers and terms and conditions, including retailer approaches to customer billing.

### 2.2.1 Technical Efficiency

A key objective of NECF is to improve the efficiency of the operation of retailers, noting that most retailers in the National Electricity Market (**NEM**) operate in more than one State or Territory. A premise underlying NECF is that differing regulatory requirements in each jurisdiction result in additional costs being incurred by retailers, either tailoring their operations to the individual requirements of each jurisdiction or adopting an approach of applying the most stringent requirement (and hence costly) identified in any jurisdiction on a national basis.

Two initial considerations are: how to test or confirm whether the implementation of NECF results in increased efficiencies in practice; and, whether any efficiencies may occur in stages, rather than immediately. In relation to the latter point, for instance, common rules should simplify the development and operation of retailer customer information and billing systems, but such efficiencies might be best achieved at the next system upgrade and may not be demonstrated (at least to their full potential) in the timeframe of the NERL Review.<sup>10</sup>

In one sense it might be *inferred* that greater consistency in regulation would always result in increased efficiencies, but the task requires the Commission to make an assessment on whether such efficiencies *have* occurred. Such an assessment should also attempt to identify the nature and extent of such efficiencies.

In terms of the evidence that the Commission will rely on to assess the extent of any improved retailer efficiencies, submissions from retailers that efficiencies have occurred and the level of savings made will play an important role. Indeed given that a key impetus for NECF was the achievement of economies in operation for retailers that operate across State and Territory borders, there should be some onus on retailers to be forthcoming in demonstrating any efficiencies achieved.

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<sup>10</sup> Noting that as of October 2013, all NEM jurisdictions other than Victoria and Queensland had adopted NECF.

The Commission will be seeking as much hard evidence as possible, rather than rely on assertions. As indicated in the introduction, four jurisdictions have now adopted NECF, and at varying times. It is proposed to ask retailers to specify the actions taken and the type of savings, and monetary value of such savings, at each point of the NECF rollout, namely:

- ▲ 1 July 2012 (NECF adopted by ACT and Tasmania);
- ▲ 1 February 2013 (NECF adopted by SA);
- ▲ 1 July 2013 (NECF adopted by NSW);
- ▲ Date to be determined when NECF adopted by Victoria and Queensland.

This will enable retailers to report as early as possible, rather than wait until the time the NERL Review is undertaken when such information may be lost.

Nevertheless, the Commission may also have to undertake some independent analysis in addition to the advice it receives from retailers.

One approach might involve estimating Electricity Purchase Cost (i.e., an estimate of the wholesale energy cost) and deducting it and network charges (which represent a significant portion of residential customer electricity bills<sup>11</sup> and movements in network charges are publicly available) from an indicative residential customer bill (e.g., derived from weighted average contract prices) to provide an estimate of retailer operating costs, which could be tracked over time. This should indicate any evidence of movement in prices becoming lower relative to costs, were this to occur.

A similar approach is employed by the U.K. regulator Ofgem which regularly publishes a retail margin indicator (an indicative annual net margin), which is the difference between the customers' retail bills and the suppliers' costs.<sup>12</sup> Gross margin is derived from deducting wholesale costs and Value Added Tax (VAT) & other from standard tariff bills for an average customer, with operating costs<sup>13</sup> then deducted to derive an estimate of net margin.<sup>14</sup>

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<sup>11</sup> Network costs, consisting of ElectraNet's transmission tariffs and SA Power Networks' distribution tariffs, comprise approximately 45% of a typical residential electricity customer bill, refer *2011/12 Annual Performance Report-Market Development*, page 3; available at <http://www.escosa.sa.gov.au/electricity-overview/reporting-and-compliance/annual-performance-reports.aspx>

<sup>12</sup> Ofgem, *Methodology for Supply Market Indicators*, January 2012; available at <https://www.ofgem.gov.uk/publications-and-updates/methodology-supply-market-indicators> and *Electricity and Gas Supply Market Indicators*; available at <https://www.ofgem.gov.uk/publications-and-updates/electricity-and-gas-supply-market-indicators-25092013> .

<sup>13</sup> Operating costs include customer service staffing, IT, sales and marketing, billing and bad debt costs.

<sup>14</sup> Note that U.K. retailers are also required to produce Consolidated Segmental Statements that provide comprehensive, backward looking, information on individual energy company revenues, costs and profits.

The Essential Services Commission of Victoria (ESCV) has also undertaken analysis of retail margins in the Victorian energy retail market, in an effort to estimate movements in retailer margins between 2006 and 2012.<sup>15</sup> The ESCV employed consultants SKM-MMA to undertake the work which involved:

*“... a ‘bottom-up’ analysis of retailer supply costs for typical customers. These costs are then compared to the estimated revenue for typical customers supplied under different types of tariffs, to obtain estimates of retailer gross margins and net margins”.*<sup>16</sup>

However, the ESCV stresses that it is important “... not to attribute a false degree of precision to the results as reported, we believe the results are indicative, interesting and relevant”.<sup>17</sup>

The two main types of retailer costs identified for the ESCV study were wholesale supply cost to retailers (purchased energy costs, adjustment for line losses, network charges, green scheme costs and market operation fees) and retailer operating costs.

The suggested approach outlined above for the NERL Review would effectively derive an estimate of operating costs plus net margin, but may be sufficient for monitoring broad trends in operating cost for the purposes of the review.<sup>18</sup> It would be important to be able to derive pre-NERL estimates on a similar basis, for comparison purposes.

### 2.2.2 Allocative efficiency

The Commission proposes to review the competitiveness of the South Australian energy retail market as the primary basis for assessing the extent to which the adoption of NECF has achieved allocative efficiency gains.

It is the Commission’s view that the performance of the customer protection regulatory framework must be assessed within the context of the market it governs. A key element in assessing the performance of the market is to determine the level of retail competitiveness: are consumers gaining access to competitively set prices and is the NERL consumer protection framework robust enough to operate in such an environment?

The Commission<sup>19</sup> and the AEMC<sup>20</sup> have previously undertaken formal reviews into the competitiveness of the South Australian energy retail market (in 2007 and 2008

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<sup>15</sup> Essential Services Commission of Victoria, *Analysis of Electricity Retail Prices and Retail Margins 2006-12*; available at <http://www.esc.vic.gov.au/Energy/Analysis-of-Electricity-Retail-Prices-and-Retail-M>.

<sup>16</sup> *Op. cit.*, page 6.

<sup>17</sup> Essential Services Commission of Victoria, *Retailer Margins in Victoria’s Electricity Market, Discussion Paper*, May 2013, page 1.

<sup>18</sup> Consideration would need to be given to how sophisticated such an analysis should be, for example, the extent to which costs such as the FIT premium and REES should be separately identified and dealt with. It may also be practical to limit the exercise to the top three or four retailers, given that the combined market share would cover most of the retail market. Were there to be any evidence of increasing retailer net margins, then a separate estimate of retailer operating costs might need to be derived.

<sup>19</sup> In January 2007, the Commission appointed NERA Economic Consulting to undertake a *Review of the Effectiveness of Energy Retail Market Competition for small customers in South Australia* (incorporating

respectively), with the Commission undertaking a monitoring and reporting role until 1 February 2013.

The Commission has previously developed a framework for monitoring the development of retail competition in South Australia, with a Final Decision released in September 2004.<sup>21</sup> The key monitoring indicators identified were:

- ▲ Indicator 1: number of retailers
- ▲ Indicator 2: small customer switching
- ▲ Indicator 3: barriers to entry
- ▲ Indicator 4: information asymmetries
- ▲ Indicator 5: price/service mix
- ▲ Indicator 6: impacts on low-income groups
- ▲ Indicator 7: innovation.

Part of the Commission review would include updating earlier monitoring work.

Reviewing price movements against total cost movements (excluding retailer operating cost) should also be instructive in indicating the direction of any changes in allocative efficiency.

### 2.2.3 Dynamic efficiency

Evidence of innovation will be a key factor in determining whether there is any evidence of dynamic efficiency improvements, with this also being a key competitiveness indicator.

In addition to potentially varied market contract offers and terms and conditions, including retailer approaches to customer billing, other areas of development could include different services provided to customers (better products), including innovative ways of interacting with and informing customers.

### 2.2.4 Distribution of benefits

A further question for consideration is: if efficiencies have been achieved, on what basis have the benefits been distributed? That is, have consumers received a share of the benefits, perhaps through lower contract prices, or have retailers (or shareholders) captured all of the benefits?

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both electricity and gas), various reports available at <http://www.escosa.sa.gov.au/projects/86/review-of-the-effectiveness-of-energy-retail-market-competition-in-south-australia.aspx#stage-list=4>.

<sup>20</sup> AEMC conducted a *Review of the Effectiveness of Competition in Electricity and Gas Retail Markets in South Australia* in 2008, various reports available at <http://www.aemc.gov.au/Market-Reviews/Completed/review-of-the-effectiveness-of-competition-in-electricity-and-gas-retail-markets-in-south-australia.html>.

<sup>21</sup> Essential Services Commission of South Australia, *Monitoring the Development of Energy Retail Competition in South Australia*, Final Decision, September 2004; available at <http://www.escosa.sa.gov.au/library/040917-MonitorEngyRetailComp-FinDec.pdf>.

Depending on the size of the efficiencies gained, it may be difficult to determine the beneficiaries of any shared benefits. Nevertheless, in accordance with the Commission's primary objective, the focus of the Commission's assessment will be the extent to which the long term interests of South Australian consumers have been served, i.e. the extent to which customers have benefitted.

**Question 3:**

**Should the Commission adopt a broad economic interpretation of the term 'efficiency'?**

**Question 4:**

**Should the Commission consider the extent to which the South Australian energy retail market is effectively competitive as part of the NERL Review?**

**Question 5:**

**If so, is the Commission's proposed approach to undertaking an assessment of the level of effective competition in the South Australian energy retail market sufficiently comprehensive?**

**Question 6:**

**Are there any other considerations the Commission should have regard to in making an assessment on the extent and nature of efficiencies resulting from the implementation of the NERL?**

### *2.3 Review of pricing outcomes*

As indicated above, monitoring pricing outcomes:

- ▲ is integral to the NERL Review as an explanatory variable;
- ▲ will assist in determining the extent to which technical efficiency has been achieved, through comparing cost movements against price movements; and
- ▲ is important in assessing the effective competitiveness of the South Australian energy retail market, as a means of determining the extent to which allocative efficiency has been achieved (e.g., through observing the nature of any changes in price/service mix).

Prices are important in assessing the effective competitiveness of the South Australian energy retail market. Competition is not an end in itself, but, where effective, is most likely to deliver prices that are in the long term interests of consumers.

Based on historic data collected from retailers for use in the Commission's relative price movement (RPM) process, there is a significant proportion of market contract customers purchasing electricity under what might be termed 'closed offers' at any given point in time



(i.e. still operating, but are closed to new customers), in addition to ‘open offers’ (those available to customers on request).

By reviewing open and closed offers, the Commission can comment on the extent to which retailers differentiate prices for new and existing customers. It is important to understand the extent to which retailers may be offering significant discounts only to new customers, meaning that retailers may be relying on customer inertia to increase prices for existing customers.

By way of example, should a large proportion of customers on closed offers tend not to respond to increased prices (“stickiness”), then this might encourage retailers to increase closed offer contract prices by more than any underlying cost increases to subsidise market offers to attract new customers. While “sticky” customers have the ability to seek the best offers available to them, it will only be by observing any evidence of stickiness that a potential market failure might be identified. For example, sticky customers perceive high transaction costs in any decision to move to a new contract (which may be real, or only perceived) which might be addressed through making more (or better) information available and/or reduce any barriers to transfer.

It is also considered important to understand the movement in weighted average prices of each type of contract, in order to provide an informed comment on the situation for customers as a whole. Reviewing movements in individual contract prices with no regard to the level of take up of specific contracts would lead to a finding that might have little bearing to that experienced by the majority of customers.

**Question 7:**

**Are there any other considerations the Commission should have regard to in relation to incorporating pricing evidence for the review?**

## 2.4 *Any other matters*

This Issues Paper has attempted to identify those matters that should be considered in the NERL Review. Members of the community are invited to suggest any other matters that they believe should be considered.

**Question 8:**

**Are there any other matters that the Commission should address in the review, that deal directly with the impact of the NERL on small consumers of energy?**

## 3. PRICE REPORTING REQUIREMENTS

This chapter discusses potential retailer price data reporting requirements for the NERL Review, noting that the final scope awaits consideration of submissions to this Issues Paper.

The Commission will collect data from public sources where available (including information from the AER), only seeking data from retailers where it is necessary to do so.

In considering any reporting requirements for non-publicly available data, the Commission will balance the need to obtain sufficient information with the level of effort and resources incurred by retailers in providing the data.

Accordingly, the Commission is presenting a number of options for comment in this Issues Paper regarding collecting data at varying levels of detail.

### 3.1 Price information

Two price information options for the NERL Review have been identified for consideration, with the expected output and data requirements of retailers discussed. The information would be required of retailers marketing to small electricity customers in South Australia during the relevant period.

#### Option 1: Modified Relative Price Movement (RPM)

Prior to the Government's decision to deregulate retail energy prices, the Commission had utilised a methodology for fixing electricity standing contract prices, in which the regulated price was adjusted annually based on the weighted average movement in market contract prices. Under that Relative Price Movement (RPM) methodology, standing contract prices were allowed to move in line with changes in market contracts, subject to prices sitting within a predetermined floor and ceiling established by the Commission.

The RPM methodology provided a sound basis for assessing the movement of weighted average electricity prices across a year, with retailers having existing systems to meet data reporting requirements.

It is not considered necessary to collect the full data set required under RPM for the purposes of the NERL Review. It is proposed that the following contract data would be sought:

- ▲ standard retail contract information (name, tariff type and description); and
- ▲ market retail contract information (name, tariff type and description);

and for each retail contract:

- ▲ billed days;
- ▲ supply charge;
- ▲ variable charge (separately for summer and non-summer tariffs); and

- ▲ sales/consumption (separately for summer and non-summer tariffs).

This information would be required separately for open and closed contracts. The required contract information would enable the Commission to aggregate the information separately according to residential and small business customers.

There would be a greater cost involved for retailers to provide this information in relation to gas contracts, given that the RPM reporting structures were only developed for electricity. The additional cost might be considered warranted noting that the gas retail market is generally considered less competitive than the electricity retail market, with far fewer (five as at 30 June 2013) retailers offering gas contracts.

#### Option 2: Average Price

Under this option retailers would only be required to provide the following information, separately for standard and market retail contracts:

- ▲ total sales (consumption)-residential;
- ▲ total sales (consumption)-small business;
- ▲ total revenue from sales-residential; and
- ▲ total revenue from sales-small business.

This information, which is consistent with previous requirements made of retailers under Energy Industry Guideline No.2 would also be required separately for open and closed contracts.

Similar to the requirements of Guideline No.2, sales and revenue data in this option and Option 1 would relate to actual billings. Consequently, the billing data may not incorporate the most recent offers (to the extent that customers have yet to be billed on those rates), but the proposed approach would pick up any such offers in the subsequent period to the extent that the offers translated into a material level of contracts being formed. A risk with focussing solely on offers is that, in practice, a low price by itself may not result in a high take up rate (i.e. conversion into contracts) if other conditions associated with the offer are not to the satisfaction of the prospective customer.

Dividing 'total revenue from sales' by 'total sales' would enable a weighted average 'price' to be derived.

While this should be an easier data set for retailers to provide, it would not allow any interrogation of movements in components or types of contracts by the Commission. Also, there would be limited ability for the Commission to assess the veracity of the data supplied.

Under all options the information sought will be limited to that necessary to enable an assessment of movements in overall energy bills over time, that is, not separate out details for certain types of market contracts (e.g. such as the accredited green component for GreenPower contracts).

The Commission does not propose to monitor movements in the level of administrative and related charges (e.g. account establishment fees). Those charges tend to be one-off and so

it is more difficult to determine the impact of any price movements in such charges for the 'average' customer. Such charges are also generally not material, on average.

**Question 9:**

**The Commission's preferred option is Option 1 on the basis that it will allow for a robust quantification of the pricing information. Views are sought on the costs and benefits of Option 1 compared with Option 2.**

**Question 10:**

**Is there an alternative option that the Commission should consider? If so, on what basis should this option be preferred over the options listed in this Issues Paper?**

### *3.2 Timing*

The detailed pricing information would be required for each financial year ending 30 June, starting with financial year 2013/14, as the first full year of operation post NECF and price deregulation. Consequently, it is proposed that retailers would be required to provide two 'annual returns' for the purposes of the NERL Review (for 2013/14 and 2014/15), noting the intended NERL Review Draft reporting date of October 2015. These annual returns would be required to be provided to the Commission no later than 31 August of the relevant year.

## 4. NEXT STEPS

Submissions and comments are sought on the issues raised in this Issues Paper and any other matter members of the community may wish to raise that is pertinent to the matters addressed in this Issues Paper. Written comments should be provided by **Friday, 13 December**. It is highly desirable for an electronic copy of the submission to accompany any written submission. Please refer to submission instructions on the inside cover of this paper.

The final framework for the NERL Review will be published once the Commission has had time to evaluate submissions received to this Issues Paper. At that time, the Commission will release a proposed reporting Guideline, should it be determined that detailed data will be required to be provided by retailers.

An indicative timetable for the review is set out below

### *Timetable for this review*

STAGE	TIMING
Issues Paper released	5 November 2013
Submissions to Issues Paper due	13 December 2013
Final NERL Review Methodology released	February 2014
Reporting Guideline released (if required) <sup>22</sup>	February 2014
First Annual Retailer Return due (if required)	31 August 2014
Second Annual Retailer Return due (if required)	31 August 2015
Draft Report-NERL Review released	October 2015
Submissions to Draft Report due	mid-December 2015
Final Report-NERL Review released	February 2016

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<sup>22</sup> References to “if required” acknowledge that a final decision is pending consideration of submissions received to this Issues Paper.



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