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Review of the Effectiveness of Energy Retail Market Competition in South Australia

Phase 1 Report for ESCOSA

NERA

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1. Introduction

This Phase 1 report represents the first in a series of reports prepared as part of the Essential Services Commission of South Australia's ("the Commission's") Review of the Effectiveness of Energy Retail Market Competition in South Australia.

Full retail contestability was introduced in the South Australian electricity and gas markets in January 2003 and July 2004 respectively. In line with its obligations under section 6 of the ESC Act, the Commission has developed a framework for monitoring the impact of full retail contestability within these markets. Under this framework, the Commission collects and publishes information from both retailers and customers in order to monitor the development of electricity and gas retail markets by reference to seven indicators of competition.

The current review represents a further development and refinement of the Commission's existing framework and bi-annual monitoring reports. The purpose of this assessment is to draw conclusions on the overall effectiveness of electricity and gas retail competition for small residential and business customers in South Australia and to make recommendations as to the means by which the Commission's retail market activities could be amended to enhance retail market competition for these customers. In light of the Commission's upcoming review of standing contract prices for both electricity and gas later this year, the Commission is particularly interested in determining whether there are any competition concerns in relation to the small customer segment that may influence the Commission's view of the appropriate form of regulation to be applied.

Under Phase 1 of this project NERA has been asked to recommend an appropriate set of criteria that could be used to assess the effectiveness of competition in the electricity and gas retail markets. However, prior to developing such criteria we believe it informative to give some consideration to how the term 'effective competition' should be interpreted in the context of this review and the framework that should be applied in conducting the analysis.

The remainder of this report is structured as follows:

- § section 2 sets out a discussion of the term 'effective competition' and how this term should be interpreted for the purpose of this review;
- § section 3 sets out our proposed framework for the assessment of the effectiveness of energy retail competition in South Australia;
- § section 4 provides an overview of the criteria adopted by ESCOSA under its current monitoring framework and that adopted by the Essential Services Commission of Victoria ('ESC') and the Office of Gas and Electricity Markets (Ofgem) in the United Kingdom in previous reviews of the effectiveness of competition; and
- § section 5 sets out the criteria we recommend the Commission adopt for the purpose of the current review.

2. What is 'Effective Competition'?

Competition can be defined as a process of rivalry among firms, where the price and output decisions of each market participant are constrained by the actions of others. In this section we provide a brief discussion of the types of competitive rivalry that may be observed in various markets and distinguish this from the degree of rivalry between players within those markets. We then discuss the meaning of the term 'effective competition' for the purpose of this analysis.

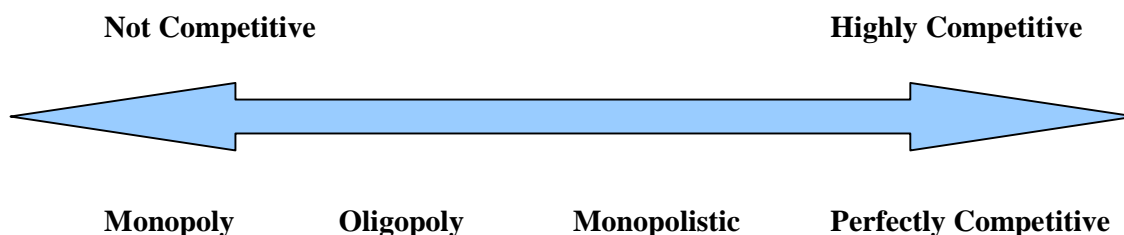
2.1. Types of Competitive Rivalry

Competition is not an absolute concept; rather, different types of competitive rivalry can be observed depending on the nature of the market in question.

Markets may range from being perfectly competitive to pure monopolies. Perfectly competitive markets are characterised by a large number of buyers and sellers each producing a homogenous product, with perfect knowledge of the conditions of supply and demand. In such markets, the cost of entry is low and producers are free to enter and exit the market over time. Because of this, the degree of competition between suppliers is generally high. Producers are effectively price-takers and have no real power to increase prices above marginal cost.

By contrast, in markets characterised by high barriers to entry, including high up-front capital costs and economies of scale relative to demand, the most efficient outcome may be for only one producer to supply the entire market. However, in markets characterised by natural monopoly and where customers have little bargaining power, it is possible for the monopolist to exert its market power by raising prices and limiting output so as to earn above-normal profits.

In reality, most markets fall somewhere in between these two extremes. For example, some markets may be oligopolistic, with high barriers to entry and only a few suppliers, eg, steel or automobile manufacturing. Other markets may be monopolistic, with relatively low barriers to entry and with a number of suppliers that produce differentiated products that are highly, but not perfectly, substitutable for one another, eg, the manufacture of toothpaste or deodorant. A diagram of the range of market outcomes is set out below.



In each of these markets firms may compete with one another in different ways. For example, in markets for the sale of a homogenous product, suppliers are likely to compete on the basis of price given the level of capacity in the market. In monopolistic markets, suppliers may compete by consistently developing new products over time, in an attempt to maintain a price premium over other products or market share.

2.2. Degree of Competitive Rivalry

In undertaking any competition analysis it is important to distinguish between the type of competitive rivalry observed in the market and the degree of competition between players in that market.

The type of competitive rivalry that exists in a market is generally a function of the product or service being produced as well as the nature and relative size of the costs of production. While some forms of market structure are more conducive to aggressive competition between suppliers, ie, perfectly competitive and monopolistic markets, this does not mean that those market structures that only encourage the entry of a small number of sellers cannot be considered highly competitive. For example, vigorous competition can occur between a limited group of individually powerful and equally matched suppliers in an oligopolistic market.

To determine whether the degree of competition in a market can be considered high or low, one must look beyond a simple analysis of market structure and assess whether the interaction between buyers and sellers in the market is such that no one producer has the ability to exert its market power, ie, to raise prices significantly above the efficient cost of supply over the long term. Such analysis helps to inform whether barriers to entry or expansion are sufficiently high to confer market power to only one supplier or whether a number of suppliers have the ability to collude or coordinate their activities so as to maintain prices above a 'competitive' level.

2.3. Effective Competition

Even where it is possible to assess the extent to which competition between suppliers has resulted in prices at a level above the long-run cost of supply, the question arises as to what point can one say that the degree or level of competition in a market is 'effective'?

In 1975 the Trade Practices Tribunal (now the Australian Competition Tribunal) considered the meaning of the term effective competition, noting the following:¹

“The basic characteristic of effective competition in the economic sense is that no one seller, and no group of sellers acting in concert, has the power to choose its level of profits by giving less and charging more. Where there is workable competition, rival sellers, whether existing competitors or potential entrants in the field, would keep this power in check by offering or threatening to offer effective inducements....”

In our view, effective competition requires that both prices should be flexible, reflecting the forces of demand and supply, and that there should be independent rivalry in all dimensions of the price-product-service packages offered to consumers.”

¹ Re *Queensland Co-operative Milling Association and Defiance Holdings Ltd* (1975), APTR 40-012, at 17 and 245.

This view suggests that the benchmark for effective competition need not be based on the theoretical construct of a perfectly competitive market or that prices should be at or very close to the long-run cost of supply. Rather, it implies that for competition in a market to be considered effective, there should be sufficient rivalry between existing or potential competitors to keep the market power of all producers in check. In other words, the level of competition should be sufficient to ensure that no one producer can earn significant above-normal profits, or continue to provide a sub-optimal range of products or services through the exercise of its market power.

We note that this interpretation is similar to that adopted by the ESC in its assessments of the effectiveness of energy market retail competition in both 2002 and 2004.² In its 2002 review the ESC identified the following characteristics that competitive markets would normally possess:³

- § a sufficient number of buyers and sellers and/or freedom of entry and exit so that customers remain contestable and free to exercise choice;
- § rivalrous and innovative conduct on the part of sellers and the widespread exercise of market choice by well informed buyers; and
- § differentiated products and services that reflect innovations on the part of sellers in response to the preferences of customers, and prices that reflect the efficient cost of those products and services.

In this review, the ESC explicitly recognised that full retail competition for the small customer retail segment was in its infancy and that there were market developments occurring that were yet to fully manifest themselves.⁴ In its later review in 2004, the ESC also noted that the market was still in its formative stage but that competition was generally effective in constraining prices and was likely to become effective for a much larger proportion of small energy customers over the next few years as competition continues to build and the effects of measures to enhance competition are felt.⁵

Given that full retail contestability was only introduced for electricity customers in South Australia in January 2003 and for gas customers in July 2004, we would not expect competition to have fully matured in these 'markets'. However, if the conditions for competition are present, we would expect to observe new entry for a range of customer classes, the emergence of new types of competitive contract offerings with varying terms and conditions and some level of customer switching between retailers in response to these competitive offerings. Where such evidence suggests that smaller new entrants have imposed

² See ESC, *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity – Final Report*, September 2002, p.18 and ESC “*Special Investigation: Review of the Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity – Background Report*”, June 2004, p.4.

³ ESC, *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity – Final Report*, September 2002, p.18.

⁴ ESC, *Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity – Final Report*, September 2002, p.78.

⁵ ESC “*Special Investigation: Review of the Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity – Overview Report*”, June 2004, p.3-4.

some level of constraint on the incumbent retailer and that competition between the incumbent and these new entrants is likely to strengthen over time, and in particular to expand into customer segments where new entrants have not had a significant presence, then we would consider the market to be effectively competitive.

3. Framework for Analysis

We propose to adopt the following framework for the purpose of the current review:

- § *Step 1* – Define the relevant market or markets for consideration;
- § *Step 2* – Assess the structure of the relevant markets;
- § *Step 3* – Assess the conduct of participants (both suppliers and consumers) with each relevant market; and
- § *Step 4* – Assess the performance of participants within each relevant market.

We consider each of these steps in greater detail in sections 3.1 to 3.4 below.

3.1. Defining the Relevant Markets

Market definition is an important first step in any competition analysis since it identifies the relevant arena in which competition is to be assessed.

The process of defining the relevant market typically involves consideration of four primary market dimensions; product, geographic, functional and time (with most focus generally on the product and geographic dimensions). Generally, producers that supply different products, or that are located in different areas, are considered to operate within the same market if:

- § a substantial number of consumers are willing and able to substitute the good or service of one producer for the other (referred to as demand-side substitution); or
- § producers can easily switch supply from one product to the other in response to a change in the relative price of both products (referred to as supply-side substitution).

For the purpose of the current review it is necessary to consider the product and geographic bounds of the relevant energy retail markets. In particular, it is necessary to consider whether there are separate markets in South Australia for:

- § the retail of electricity and gas supplies; and/or
- § the supply of electricity and/or gas to different end users, ie, residential, small business, large commercial users and industrial users; and/or
- § the supply of electricity and/or gas to urban and regional areas.

3.1.1. Substitutability of Electricity and Gas Supplies

While electricity and gas are both energy sources, their application by end users and their accessibility limit the extent to which they may be viewed as substitutes. Even where gas is fully reticulated, it does not constitute a perfect substitute for electricity. While reticulated gas and electricity are substitutable for a range of uses such as heating and cooking, they are not substitutable for other important essential functions such as lighting and domestic and business appliance applications, eg, powering refrigerators or computers. The ability for

consumers to substitute gas for electricity may therefore be limited. If a sufficient number of customers could not substitute a substantial proportion of their total energy needs from the use of electricity to the use of gas in order to defeat a small but substantial non-transitory increase in the price (SSNIP) of electricity above the competitive level, this would imply the existence of separate markets for these two energy sources.

There is also very limited supply side substitutability between the retail of electricity and gas. As noted by the ESC, the provision of electricity and gas requires different wholesale, transmission, distribution, use of system and customer agreements such that a retailer of electricity would be unlikely switch to the supply of gas in response to short term price movements of these two products.⁶ Such switching would take considerable time and effort and may be considered market entry as opposed to supply side substitution.

We note that the existence of dual fuel retailers that sell electricity and gas as a bundled product does not alter the level of demand or supply-side substitutability between these two energy sources. While such retailers may be able to take advantage of price or margin differentials by targeting specific consumer groups, this does not alter the extent to which customers can substitute these two energy sources. However, we note that in future, the level of demand side substitutability may increase to the point where the supply of electricity and gas could be considered to be within the same market. The increasing availability of gas powered appliances and the increased opportunity and/or willingness for customers to consider installing a gas connection may increase the potential for switching between these two energy sources.

On the basis of the above we consider there to be separate product markets for the retail of electricity and the retail of gas.

3.1.2. Customer Classes

The extent to which there are separate markets for the supply of electricity and gas to (a) residential and small business customers; and (b) commercial and industrial customers ultimately depends on the extent to which a retailer would be required to undertake substantial capital investment on different systems and processes in order to switch supply between these two customer groups.

As noted by the ESC in its 2004 review, it has previously been contended that retailers competing for commercial and industrial customers are not immediate potential entrants in the residential and small business segment because of differences in the business systems, operations and know-how required to supply electricity to these two customer groups. For example, commercial and industrial customers often negotiate specialised long-term contracts for the supply of substantial quantities of electricity and/or gas. By contrast, residential and small business customers tend to source much smaller quantities of supply under standard contracts made available to a large number of customers. The systems and processes required to support the sale of electricity and gas to these two customer groups are therefore likely to be quite different.

⁶ ESC “*Special Investigation: Review of the Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity – Background Report*”, June 2004, p.15.

While it is unclear whether there are separate markets for the retail of electricity and gas to industrial/commercial and residential/small business customers, we note the Commission wishes to limit the current review to an assessment of the effectiveness of competition for only one of these customer segments. We therefore consider residential and small business customers to be in a separate market to industrial or larger commercial customers for the purpose of this review.

We will also consider issues that are relevant to low-income customers for the purpose of this review. While low income customers do not represent a separate market unto themselves, it is relevant to consider whether competition for this particular customer class is sufficiently effective to inform the Commission's approach to its review of AGL and Origin's standing tariffs for electricity and gas supply in 2007.

3.1.3. Geographic Bounds of the Relevant Markets

Another relevant consideration for the purpose of the current review is whether the geographic bounds of the relevant markets is nationwide (Australia or eastern Australia), state-wide (South Australia) or whether there are narrower regional geographic markets for the retail of electricity and gas within South Australia, eg separate markets for metropolitan Adelaide and rural and regional South Australia.

Factors that influence the geographic delineation of electricity and gas retail markets include the physical reach of transmission and distribution infrastructure and the ability for retailers to contract wholesale energy supplies to each area. However, in general, it is reasonable to suggest that the cost structure of energy retail businesses is such that a retailer supplying customers in metropolitan areas would be likely have both the ability and incentive to switch supply to rural or regional areas in response to price signals (and vice versa). This would suggest that the relevant geographic market is at least as wide as South Australia.

The main cost components of a retail business are network costs and the cost of wholesale energy supply. In South Australia network tariffs are geographically averaged, which means that retailers bear no additional network costs when supplying customers in rural or regional areas. There are also no substantial differences in the cost of acquiring wholesale electricity supplies for delivery to rural areas vs. metropolitan Adelaide, although we note that such cost differences are likely to exist for the supply of gas, where the cost that a retailer faces relative to other competitors for supply to regional areas depends on whether gas is sourced from Moomba or from gas basins in Victoria

While the relevant markets may be state-wide, there may be some instances where it is useful to consider the extent or impact of competition within narrower geographic areas to identify sub-markets where competition between retailers may be less effective. Given this, we will consider the geographic bounds of the relevant markets to be South Australia and will assess the differential impact of competition within metropolitan Adelaide and rural and regional South Australia separately where relevant.

3.1.4. Summary of the Relevant Markets

To summarise, for the purpose of this analysis we propose to define separate markets for the retail of electricity and gas within South Australia to residential and small business customers.

Regardless of this market definition, for certain parts of the analysis we will consider the extent to which competition is effective for particular customer groups, defined either by consumption level, geographic location or income level.

3.2. Assessment of Market Structure

After defining the relevant markets for analysis it is possible to assess the structural characteristics of each. Such analysis provides some indication of the type of competitive rivalry to be expected between market participants and the scope for effective competition within those markets.

Competition authorities such as the Australian Competition and Consumer Commission (ACCC) generally consider the following market structure characteristics when conducting competition assessments:⁷

- § *the number of customers and suppliers* – the existence of only a small number of suppliers may reflect structural characteristics of the market such as economies of scale and scope but may also be an indicator of the extent to which suppliers have the ability to exert their power in a market, particularly in markets where there are a large number of small customers with little bargaining power;
- § *the history of entry, exit and consolidation in the market* – evidence of market entry and exit demonstrates the extent to which new entrants may be capable of overcoming entry barriers. Consolidation or vertical integration between suppliers may reflect structural factors such as economies of scale and scope or dynamic competitive pressures and opportunities over time, but may also provide more integrated firms with the ability to increase and potentially exert their market power.
- § *the market share of suppliers and the level of market concentration over time* – market concentration refers to the relative number and size of participants in a market, ie, it refers to how evenly market shares are allocated between suppliers. While the existence of a small number of suppliers with large market shares may be indicative of structural features of the market it may also be indicative of the ability for one or more suppliers' to exercise its market power by unilaterally raising prices or coordinating behaviour with other suppliers in ways that discourage competition and new entry. Market concentration is most successfully captured by the Herfindahl-Hirschman Index (HHI), computed as the sum of squares of market participants' shares of the market. A market in which one firm holds a 100 percent market share will have a maximum HHI index of 10,000;
- § *barriers to entry, expansion and/or exit* – barriers to entry refer to any feature that puts prospective new entrants at a disadvantage relative to incumbent firms. The presence of entry barriers may suggest that existing market participants are not disciplined by the threat of new firms emerging in the market and may therefore have opportunities to exert their market power by raising prices above the cost of supply. Potential entry barriers in energy retail markets include incumbent retailer advantages in terms of branding and

⁷ These market structure characteristics are considered by the ACCC when conducting merger assessments and when assessing whether corporations have the requisite degree of market power to be in breach of various competition provisions contained in the Trade Practices Act 1974.

customer awareness, economies of scale and scope, limited access to wholesale energy supplies, the availability of hedging instruments to minimise price risk and regulatory compliance costs;

We intend to consider each of the above factors for the purpose of the current review.

3.3. Assessment of Market Conduct

Market structure is not the only feature that impacts the level of competition in a market. For any given market structure, the degree of rivalry between suppliers will be influenced and evidenced by their conduct within the market.

Market conduct may be considered in terms of both supplier conduct and consumer conduct. On the supply side, evidence of suppliers aggressively marketing their product or service and potential instances of anti-competitive or misleading or deceptive conduct will help to inform the degree to which suppliers are in fact competing with one another. On the demand side, evidence of customers switching suppliers over time in response to price or quality differentials provides some indication of the extent to which customers are responsive to competitive pressures in the market.

In competitive retail markets one would expect to observe specific types of conduct from retailers and customers alike. Evidence of retailers actively competing for customers through a variety of advertising and marketing channels, and the continued development of market offers that meet the changing needs and preferences of customers are both indicative of a high degree of competition. Evidence of anti-competitive or misleading and deceptive conduct may also be indicative of competitive pressures or alternatively, could reflect the ability and willingness of retailers to exert their market power over consumers.

On the demand side, the most useful indicator of the effectiveness of competition is the extent to which customers have responded to competitive offers either by switching retailers or entering into market contracts with the incumbent retailer. Switching may be viewed as an outcome of the effectiveness of retailer actions in motivating customer responses. The rate of customer switching will be affected by:

- § the extent to which retailers are actively promoting their market offers, which will in part be affected by the margin available under the standing tariff;; and
- § customers' awareness of the choices available to them, which will vary depending upon their receptiveness to the sales channels utilised by retailers.

In an effectively competitive market, customers are likely to be well informed about available offers and will switch or retain their electricity and gas supply services with those retailers that offer the most favourable terms and conditions. However, customers may find the search for, and evaluation of information costly and time consuming. Effective competition can therefore be expected to motivate retailers to recognise such costs and undertake targeted marketing campaigns in order to make it easier for customers to make informed decisions.

Even where retailers do not target certain customer classes, effective competition may still be supported by active customer participation. Individual customers may seek to participate in the market via the services of customer aggregation providers. Such services seek to increase

demand to levels that improve the financial attractiveness of these customers to retailers and enhance the collective bargaining power of these customers. Such measures may be useful in rural and regional areas where higher customer acquisition costs may dissuade retailers from actively seeking out individual customers.

3.4. Assessment of Market Performance

In addition to the conduct of market participants, the degree of competition will be informed by the ‘performance’ of the market, or participants within the market.

One of the primary measures of market performance is the extent to which prices reflect the efficient long-run cost of supply, where such costs include a reasonable profit margin that provides suppliers with an incentive to invest and allows them to recover the costs incurred in acquiring customers. We note that while an assessment of the margins available to suppliers is a useful indicator of the extent to which suppliers compete with one another, such analysis is difficult to conduct, particularly in markets where there are significant fixed or common costs that may be allocated differently by suppliers across their individual customer bases.⁸ Given this difficulty, we do not anticipate conducting a margin analysis for the purpose of this review.

Another broad indicator of market performance is the extent to which suppliers have developed innovative and differentiated products for customers that are to some degree tailored to the needs and preferences of particular customer groups.

In energy retail markets, different customer groups may benefit from contracts with different tariff structures depending on the nature of their consumption profile. The development of various offers by retailers that provide different levels of savings to customers with different consumption profiles in comparison to the standing contract is evidence of competition at work. In an effectively competitive market one would expect to see retailers developing new and different products over time, with different price and non-price terms, that provide value to customers with different needs and preferences.

For the purpose of the current assessment we intend to assess various measures of market performance, which take account of the range of products offered by retailers and the extent to which competition between retailers has had an impact on low-income consumers.

⁸ See section 4.3.3 for more detail.

4. Summary of Criteria Used in Other Jurisdictions

Both the ESC and the Ofgem have recently conducted assessments of the effectiveness of competition in the electricity and gas retail markets in Victoria and the United Kingdom respectively. These assessments include:

- § ESC, “Special Investigation: Review of the Effectiveness of Full Retail Competition for Electricity – Final Report”, September 2002
- § ESC, “Special Investigation: Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity” Overview and Background Report, June 2004
- § Ofgem, “Domestic Gas and Electricity Supply Competition. Recent Developments”, June 2003
- § Ofgem, “Review of Competition in the Non-Domestic Gas and Electricity Supply Sectors. Initial Findings”, July 2003

A summary of the broad ‘headline’ criteria considered by the ESC and Ofgem for the purpose of these assessments, and those currently considered by the Commission are set out in table 4.1 below. For the purpose of this analysis we have separated these criteria into those relating to market structure, market conduct and market performance, even though they may not have been presented in this a manner in the relevant assessments outlined above.

The table shows that the ESC, Ofgem and the Commission have considered broadly the same headline criteria for the purpose of assessing the effectiveness of retail competition for residential and small business electricity and gas customers. We note that Ofgem’s assessment was considerably more narrow and did not take account of retailer conduct.

We note that the Ministerial Council on Energy (MCE) has also developed a set of criteria which the Australian Energy Market Commission (AEMC) will be required to consider in future reviews of the effectiveness of energy retail competition in Australia. These criteria closely match those considered by the Commission, the ESC and Ofgem as set out in Table 4.1. Given that neither the MCE nor the AEMC have provided any further information on the specific indicators they will consider when conducting future reviews, we have not given any further explicit consideration to the MCE’s criteria for the purpose of this report.⁹

⁹ The Independent Competition and Regulatory Commission (ICRC) also recently considered the competitive state of the market for electricity supplies to franchise customers in the ACT, as the basis for determining the need for a continuation of the transitional franchise tariff (TFT). Again, the ICRC considered a number of indicators of competition for the purpose of their assessment that closely match those set out in Table 4.1. The ICRC’s assessment was considerably less detailed than that conducted by the ESC and Ofgem. See ICRC, “Retail Prices for Non-contestable Electricity Customers - Final Report”, April 2006.

Table 4.1
Summary of the Criteria Considered in South Australia and Other Jurisdictions

Criteria	ESCOSA	ESC	Ofgem
Market Structure			
Number of customers and retailers	Ü	Ü	û
History of entry, exit and market consolidation	½Ü	Ü	½Ü
Market share and concentration of retailers	½Ü	Ü	Ü
Barriers to entry and/or exit	½Ü	Ü	û
Market Conduct			
Retailer Conduct			
Extent of market offers made	Ü	Ü	½Ü
Extent and type of retailer marketing activity	½Ü	Ü	û
Evidence of anti-competitive or misleading or deceptive behaviour by retailers	½Ü	Ü	û
Customer Conduct			
Customer switching	Ü	Ü	Ü
Customer awareness of competition and choice and ease of obtaining information	Ü	Ü	Ü
Market Performance			
Price/service mix	Ü	Ü	½Ü
Availability of innovative product offerings	Ü	Ü	½Ü
Margin analysis (Price v Cost)	û	Ü	û
Impact on specific customer classes	Ü	Ü	û

In the sections below we consider the specific indicators that the ESC and Ofgem used in assessing each of the relevant ‘headline’ criteria outlined in table 4.1 below, and how these measures differ from those currently used by the Commission under its monitoring framework. In section five we set out our recommendations on the specific indicators that we believe should be considered for the purpose of the Commission’s current review.

4.1. Market Structure

In its assessments the ESC considered the number of retailers, the history of entry, exit and consolidation, market shares and concentration and barriers to entry as important indicators of market structure. Ofgem and the Commission considered a smaller subset of these broad criteria. The specific indicators considered and the way in which these were measured by each of the ESC, Ofgem and the Commission is discussed in the sections below.

4.1.1. Number of customers and retailers

The ESC assessed the number of small electricity and gas customers and indicated whether these customers acted individually in their relationship with retailers or whether a number of these customers were represented by groups that negotiated with retailers on their behalf. The ESC also assessed the number of electricity and gas retail license holders and indicated if the licensees were active, ie, retailers that have sold, or are currently selling electricity to customers, and/or restricted.

The ESC differentiated between local full service retailers (dual fuel incumbents who inherited or purchased their franchises post deregulation), non-local full-services retailers (dual fuel or electricity only non-incumbents who aim to increase their market share at the expense of local retailers) and non-local niche retailers (dual fuel or electricity only providers that operate on a smaller scale and focus on specific customer classes).

Ofgem set out a list of ‘suppliers’ (retailers) within its discussion of market shares but did not specifically consider the number of retailers currently supplying or licensed to supply customers. It is unclear whether there were other inactive licensed retailers that were not listed.

Under Indicator 1 of its current monitoring framework, the Commission reports the number of South Australian licensed retailers and the number of retailers serving large customers¹⁰, residential customers¹¹ and small business customers⁷, based on information provided by retailers under current reporting requirements. The Commission also considers, from time to time, the number of retailers participating in and/or intending to target over the coming year (a) defined residential market sub-groups; and/or (b) defined small business market sub-groups. Residential market sub-groups are defined by reference to location (metropolitan Adelaide and rural and regional South Australia) whereas small business sub-groups are defined by reference to both location (metropolitan Adelaide and rural and regional South Australia) and consumption (0 – 80MWh pa and 80 – 160 MWhpa).

4.1.2. History of Entry, Exit and Market Consolidation

The ESC assessed the number of new entrants, the date of entry and whether retailers already had established operations in other jurisdictions. The ESC also considered the amount of retailer consolidation and vertical integration in the industry.

While recognising that retailer consolidation allows access to economies of scale and scope, the ESC noted that in the presence of other barriers to entry, such consolidation could discourage potential new entrants. In its assessment the ESC considered whether retailer consolidation was between electricity or gas only retailers or between electricity and gas retailers, and whether there was evidence that retailers have benefited from economies of scale and scope.

¹⁰ Large customers defined as having annual consumption of electricity equal to or greater than 160MWh or annual consumption of gas equal to or greater than 1TJ.

¹¹ Small residential or business customers defined as having annual consumption of electricity less than 160MWh or annual consumption of gas less than 1TJ.

The ESC also considered signs of vertical integration between retail and generation companies, which, in addition to acquisitions, include strategic alliances, contractual relationships and passive investments. Again, the ESC recognised that while vertical integration of a retailer with a wholesale business may provide benefits such as access to market growth and diversification of risk, it has the potential to limit competition from new entrants if it were to lead to a reduction in risk management options open to new or non-vertically integrated retailers.

Ofgem considered market entry only in the context of competition for the non-domestic (ie, non-residential) electricity and gas sectors where it considered the number of non-domestic licensees that had entered the market between 2001 and 2003. Ofgem did not consider the degree of retailer consolidation or vertical integration in the industry, although did note that so long as both wholesale and retail markets are effectively competitive, vertical integration is not likely to be anti-competitive or damaging to consumers.¹²

Like Ofgem, the Commission currently considers the history of entry and exit of licensed retailers but does not consider the degree of retailer consolidation or vertical integration in the industry.

4.1.3. Market Share and Concentration of Retailers

In Victoria, the ESC assessed the market share of all retailers for small businesses and residential customers living in metropolitan, inner regional and outer regional areas on the basis of NEMMCO monthly reporting data (for electricity) and VENCORP meter data (for gas). Recognising that total market shares are influenced by the starting point for competition (by taking account of those customers that still remain on standing offer contracts), the ESC also considered the market share of retailers across these customer groups for market contracts only on the basis of CreativeEnergy survey data. In addition to market shares, the ESC also considered the HHI for all customer groups within the electricity and gas markets, for all customers and for market contract customers only.

In its assessment of competition for domestic customers, Ofgem considered the market share of suppliers for all customers over time (1999 – 2003) and by payment type (debit, credit, and prepayment). For electricity customers, Ofgem also considered the market share of ex-PES suppliers by geographic area. Ofgem also attempted to measure supplier share of dual fuel customers by identifying suppliers' shares of customers taking both electricity and gas from the same supplier.

In its assessment of non-domestic customers, Ofgem considered the aggregate share of the top three and top six suppliers for all customers and for customers with different consumption levels (for electricity below 200MWh, 200 – 30,000 MWh and above 30,000 MWh and for gas below 50,000 therms, over 50,000 therms and interruptible market). It also considered the HHI for the gas and electricity market and for each of these market sub-groups. Ofgem also listed the licensees supplying each of these customer segments by market share bands (up to 5%, 5 – 10%, 10 – 15% and over 15%) based on both meter points and by volume.

¹² Ofgem, "Domestic Gas and Electricity Supply Competition. Recent Developments", June 2003, p.9.

The Commission does not currently consider the market share of retailers as a specific indicator of competition under its monitoring framework, although did publish some market share statistics in its 2005/06 Annual Performance Report.¹³

4.1.4. Barriers to Entry

In its assessments the ESC considered the likely size of a number of specific potential barriers to entry in the electricity and gas retail markets on the basis of submissions and interviews with licensed retailers and potential entrant retailers, ie, including retailers licensed in other jurisdictions but in not Victoria. These barriers to entry included:

- § *Price regulation* – there is a risk that the Government may set regulated prices too low to permit widespread competitive market offers. Uncertainty about the longer-term approach to retail price regulation may also deter new entry;
- § *Incumbent retailer advantages* - existing providers may have developed a recognisable brand, significant customer base and efficient systems and processes which would be difficult for new entrants to replicate in a short period of time. Moreover, incumbent retailers poses data on existing customer usage patterns in order to better target their marketing and customer retention activities;
- § *Access to wholesale energy supply* - to enter an energy retail market, a prospective retailer must secure supply of the energy commodity as well as access to transmission and distribution network services. It must also be able to mitigate financial risk associated with volatility in energy prices. The availability of competitively priced supplies and hedging products may therefore influence new entry;
- § *Economies of scale and scope* - incumbents may benefit from economies of scale and scope, which would allow them to provide services at lower average cost;
- § *Regulatory compliance* - systems development costs imposed by regulation may act as a barrier to entry to the electricity or gas markets. Non-price regulatory requirements include gaining necessary licenses and approvals and managing differences in regulatory arrangements across jurisdictions; and
- § *Business to business (B2B) systems and processes* – these arrangements incorporate end-to-end transactions between retailers and customers for the purpose of billing and customer transfers. The ESC raised concerns that inefficient systems and processes may raise barriers to new entry and may impede future acceptance of market contracts on a large scale and may also impede the adoption of interval metres.

Ofgem did not specifically consider barriers to entry in its assessment of competition for either domestic or non-domestic customers.

The Commission currently considers the existence of barriers to entry as one of its seven indicators of competition. Within its retailer survey the Commission asks participating

¹³ See ESCOSA, “2005/06 Annual Performance Report: Performance of South Australian Energy Retail Market”, November 2006, p.72.

retailers to indicate, on a scale of one to five, the relative importance of sixteen potential barriers to entry for both the electricity and gas retail markets. Retailers are also asked to make additional comments if they believe there to be other potential barriers of concern. To date, the Commission has not reported the views of retailers on the strength of barriers to entry.

4.2. Market Conduct

Market conduct may be considered in terms of both retailer conduct (extent of market offers made, extent and nature of marketing activity and misleading or anti-competitive behaviour) and customer conduct (switching, expressions of awareness of choice and competition, views on ease of obtaining information and understanding of contract terms and conditions). Each of the ESC, Ofgem and the Commission currently consider a number of these factors as indicators of the effectiveness of competition.

4.2.1. Extent of Market Offers Made

Both the ESC and the Commission consider the extent of market offers made by retailers. For its 2002 assessment, the ESC commissioned Wallis Consulting Group to survey residential and small business customers to identify who initiated contact more frequently, suppliers or consumers, and which groups were more likely to be targeted by suppliers. For its 2004 assessment, the ESC also conducted a customer survey to determine the proportion of customers that had been contacted by a retailer with a market offer. The ESC also considered the extent to which retailers were targeting specific customer classes and the reasons for this based on submissions and interviews with retailers.

Under Indicator 5: Price/service mix, the Commission assesses the extent and nature of offers being made to residential and small business customers, where customers are defined by their income, level of consumption or geographic location. The Commission appears to report the number of customers that have received an offer by a retailer in section 3 of its six monthly statistical reports under Indicator 2: Customer switching.

Ofgem considered the number of offers made for its review of competition for non-domestic electricity and gas customers. However, the offers considered were those made under competitive tender arrangements for long-term supply, generally for larger commercial and industrial customers.

4.2.2. Extent and Type of Retailer Marketing Activity

In both its 2002 and 2004 reviews, the ESC considered the type of marketing activity conducted by retailers, including door-to-door sales, telemarketing, direct mail, billboards and internet advertising, on the basis of retailer survey data. The ESC recognised that marketing strategies range between retailers and include:

- § Retention strategies - whereby they acquire customers to maintain their current portfolio of customer classes on market contracts;
- § Aggressive strategies - focused on winning customers serviced by competing retailers; and/or

§ Reactionary strategies - whereby retailers market to their own customers in the wake of competitors' marketing campaigns.

In 2002 the ESC also assessed the monthly advertising expenditure undertaken by the incumbent retailers over the previous 14 months, which included periods both before and after the introduction of full retail competition. This analysis was based on data from the Nielsen Media Research's AdEx Database.

Neither Ofgem or the Commission have assessed the type of marketing activity undertaken by retailers on the basis of retailer surveys, although the Commission does assess the sources of information obtained by customers on the basis of customer survey data. These sources include the retailer, representatives of the retailer, advertisements, the internet or friends, family or colleagues.

4.2.3. Evidence of Anti-Competitive, Misleading or Deceptive Behaviour by Retailers

In Victoria, the Energy and Water Ombudsman (EWOV) handles customer complaints and notifies regulatory agencies of material or systemic breaches by retailers of their obligations. For both the 2002 and 2004 reviews, the ESC assessed those market conduct complaints made to the EWOV relating to electricity, gas, and dual fuel retailers. The ESC considered the relative increase in complaints since the onset of full retail competition, the extent to which complaints increased with marketing activity and the extent to which the number of complaints differ between electricity, gas and dual fuel offers and by type of marketing activity conducted. The ESC also compared the level of complaints in the electricity and gas industries with those received in relation to conduct by retailers of another essential service: land line telephone services.

While the Commission does not consider evidence of anti-competitive behaviour, it does consider evidence of misleading or deceptive behaviour by retailers on the basis of customer survey data, where customers are asked whether they have experienced one or more of a range of behaviours, including high pressure selling, providing misleading or deceptive information, not adhering to cooling off requirements or charging tariffs higher than that originally quoted.

4.2.4. Customer Switching

The ESC, Ofgem and the Commission all consider the extent of customer switching as an indicator of the effectiveness of competition in electricity and gas retail markets.

The ESC considered the level of customer switching for both its 2002 and 2004 review. In its 2004 review, the ESC considered the level of gross switching by small customers, which measures the total number of changes in the retailer assigned to each connection point, for the period January 2002 to April 2003. The ESC also assessed the level of net switching, which measures the erosion of the local retailer's market share and accounts for multiple transfers by one customer away from and back to the incumbent that may be counted in gross switching figures, for the period January 2003 to April 2004. Both the gross and net switching measures were based on NEMMCO and VENCORP data for electricity and gas respectively. In order to provide some context for the results of its analysis, the ESC

compared gross switching in Victoria with that found in other jurisdictions over time, namely: New South Wales, New Zealand and the United Kingdom. It also compared the share of all electricity and gas customers on market contracts across Victoria, New South Wales and South Australia as at December 2003.

In order to assess the impact that “move-in’s”¹⁴ had on the analysis, the ESC assessed the reasons for switching provided by customers, including “change retailer, same premises”, “move in – choose non-local”, and “move in – return to local retailer”.

In the United Kingdom, Ofgem considered the proportion of total customers that have switched (gross switching), the proportion of customers that have switched from the incumbent to a new retailer (net switching), and also the proportion of customers that have switched more than once over the period 1996 to 2003. For the period April 2002 to January 2003, Ofgem also considered the level of net switching by customer sub-groups which were defined by reference to socio-economic status, payment type and income level.

Ofgem also assessed customers’ likelihood to switch providers within the next 12 months by region and payment type, based on the results of survey data. Ofgem utilised data from J.D. Power and Associates Domestic Gas and Electricity Customer Studies, MORI surveys conducted in 2001 as well as data from Meter Point Administration Service providers for domestic gas and electricity suppliers. For the non-domestic customer segment, Ofgem considered the proportion of customers that had never switched, had switched once or had switched twice or more. It also considered the proportion of transfers objected to by customer type (contract, debt or other).

The Commission currently assesses the level of customer switching under Indicator 2: Small customer switching. The Commission currently measures the number of completed transfers to market contracts and the number of transfers in progress on the basis of NEMMCO and REMCo data and AGL and Origin Energy data. The Commission also considers the number of residential and small business customers switching by defined categories (income, consumption and location) and customer intentions to switch and the reasons provided based on small customer survey responses.

4.2.5. Customer Awareness of Choice and Ease of Obtaining and Comparing Information

The ESC, Ofgem and the Commission each consider customer awareness of the ability to switch retailers and the extent to which customers find it easy to access and understand information regarding the market offers made available to them.

For its 2002 and 2004 reviews, the ESC contracted Wallis Consulting Group to conduct a survey of customers subject to the safety net to learn if customers were aware of their ability to choose their electricity and/or gas provider. Among other questions, customers were asked whether they were aware of their right to choose their electricity and/or gas retailer and to name their current retailer and any alternative retailers they knew about.

¹⁴ A “move-in” refers to customer that switch retailer when they move house in order to stay with their chosen retailer.

In addition to soliciting information about customer's views on their ability to switch, the ESC also tried to gauge the ease with which customers were able to obtain and compare information on the market offers available to them. The ESC specifically considered the sources of information that consumers could access, the ease with which customers were able to navigate retailer's websites, the length of time it took for offers to arrive in response to customer requests and customer views on the complexity of offers made and the ability to compare market offers across retailers.

In the United Kingdom, Ofgem observed the extent to which customers felt informed about gas and electricity retail competition and the extent to which they felt they could exercise their choice to change providers on the basis of data from J.D. Power and Associates' domestic gas and electricity customer studies conducted in 2001 and 2002. The survey was carried out for various geographies and customer and payment types. J.D. Power and Associates also measured customer satisfaction with current retailer and ease of comparing information they provide on alternative options.

The Commission currently considers the level of customer awareness of the ability to switch retailer under Indicator 4: Information asymmetries on the basis of customer survey data. As part of its customer survey, the Commission also asks respondents to indicate the ease with which they are able to understand offers made to them on a scale of one to five (one being very easy and five being very difficult).

4.3. Market Performance

Market performance measures include the extent to which retailers offer a range of differentiated services that are priced according to their differences, the extent to which retailers have developed new and innovative products over time and the extent to which retailers are pricing above the long-term cost of supply. The ESC, Ofgem and the Commission each consider, to some extent, the price/service mix and the extent to which retailers are developing innovative products through either their price or non-price terms and conditions. The ESC is the only regulator that has attempted to measure the margin that retailers are currently making on the sale of electricity and gas to small customers. The ESC and the Commission also give some regard to the impact that competition has had on vulnerable customer classes.

4.3.1. Price/Service Mix

In its 2004 review the ESC conducted a market offer analysis whereby it assessed a range of gas and electricity market contracts in an attempt to measure the extent and scope of the benefits being offered by retailers. The ESC defined benefits as either 'price' benefits, ie, a dollar discount to the standing offer tariff, or 'non-price' benefits, ie, benefits not directly related to the supply of energy such as loyalty payments paid a period after the start of a market contract.

In order to complete its pricing offer analysis, the ESC asked retailers to supply data on average revenue from market contract customers, average revenue from standing offer customers and samples of the market contracts offered in 2003 to various types of customers. The ESC then calculated the savings available under various market offers in Victoria and compared this with savings available to customers in other jurisdictions on the basis of

information provided by one particular retailer. In conducting this analysis the ESC took account of various pricing issues raised by retailers, including those relating to tariff structures and off-peak electricity usage. The ESC also estimated the number of customers with competitively priced offers available in metropolitan and regional areas on the basis of consumption levels to determine whether savings were available all customers or were confined to only a subset of electricity and gas customers.

Ofgem's analysis of the price/service mix was somewhat simpler than that conducted by the ESC. In its assessment of competition for domestic customers, Ofgem measured the number of suppliers offering discounts to the offer made by the incumbent supplier and the maximum percentage discount available to customers with varying consumption levels and payment terms.

The Commission currently collects, and publishes via the Estimator, a considerable amount of information to allow customers to calculate the lowest priced market contract available for their consumption profile. The Commission also collects information from customers under Indicator 5: Price/service mix, in relation to the main reasons for customer switching. In its six monthly Statistical Reports the Commission has estimated the potential savings available to customers on market contracts with a mid-range annual consumption level of 5,000 MWh, with and without off-peak hot water, and has assessed the potential savings available relative to the standing offer contract over time. The Commission has also considered the size and extent of early termination charges for market contracts and other additional fees imposed by retailers including those for metre reading and testing.

4.3.2. Availability of Innovative Product Offerings

In addition to its assessment of the savings available under market contracts, the ESC also considered the extent and development of non-price product innovation. The ESC listed the types of non-price product offers made on the basis of submissions and consultations with retailers. These included dual fuel billing, dollar vouchers to be used toward home service work (electrical, gas appliance repair) and vouchers for movies, restaurants and other items. The ESC identified both the reason for the development of these offers, eg, building brand awareness through alliances, and the customer classes to whom these offers were targeted.

Ofgem also considered, albeit only briefly, the type of non-price offers being made to domestic customers, including affinity deals, which allow customers and suppliers to benefit from partnerships with other leading retail brands through bundled offers, loyalty points, and better customer retention and acquisition channels, and green tariffs, which allow customers the choice of sourcing their energy from renewable energy sources. Ofgem did not conduct a detailed assessment of the extent of these non-price offers or the extent to which these offers were targeted at particular customer classes.

Under Indicator 7: Innovation, the Commission collects information on the level of perceived product innovation on the basis of responses to both retailer and customer surveys. In particular, the Commission asks customers to rank, on a scale of one to five, whether they believe there is a greater variety of offers compared to a year ago, and whether, in comparison to a year ago, the offers are more innovative. The Commission also asks retailers to outline the nature of any innovative product offerings that they have made available,

whether these offerings were developed within the last twelve months and whether such offerings are confined to particular customer categories or energy types.

4.3.3. Margin Analysis

The ESC is the only regulator to consider profit margins as an indicator of the effectiveness of competition.

For its 2004 review, the ESC analysed the net margin available under the major residential and small business standing offer tariffs in each retail zone, for the average customer in each major tariff group and for customers with different consumption volumes. The net margin was defined as standing offer revenue minus the efficient cost of supply. In order to conduct this analysis the ESC estimated the efficient cost of supply based on data collected from retailers and other publicly available information sources.

Before presenting its analysis the ESC noted that meaningful margin analysis at the level of customer classes and tariff categories is difficult to undertake as such analysis must necessarily be based on broad estimates of benchmark costs and assumptions as to how these costs are allocated by retailers between customer classes given their specific pricing strategies. The ESC noted that given these difficulties, such margin analysis can be misleading and must be interpreted with caution, having regard to the assumptions made and the limitations of the data on which the analysis is based.

The ESC further noted that its margin analysis did not take into account the recovery of customer acquisition costs which retailers would reasonably expect to recover in order to undertake marketing and customer purchase activities.

4.3.4. Impact on Particular Customer Classes

The ESC and the Commission have each assessed the impact that energy retail competition has had on particular customer classes and the need for specific arrangements for low income or disadvantaged customer classes.

In its 2004 review, the ESC considered the extent to which the continuation of safety net arrangements for vulnerable customer groups was required, and whether such arrangements could be better targeted given the extent to which competition had developed for the benefit of these customers.

The Commission also currently assesses the impact of competition on low-income groups under Indicator 6: Impacts on low-income groups to determine whether these groups face particular issues and whether initiatives could be better targeted to address these issues. In particular, the Commission considers:

- § the awareness of low-income groups of the ability to switch retailer;
- § the availability of competitive offerings to low-income groups;
- § the level of switching by low-income groups;
- § changes to the hardship baseline;

§ changes in incomes and prices; and

§ issues relating to supplier interaction with low-income customers, including the number of customers experiencing payment difficulties and the number of residential customer disconnections.

In its latest Statistical Report for March 2006, the Commission assessed the change in average residential electricity prices and compared this with changes in the level of commonwealth payments over time. The Commission also assessed the change in the real value of the average pensioner electricity bill for an average consumption of 5,000MWh per annum as an indicator of the impact of retail competition on low-income groups.

5. Proposed Criteria

On the basis of the information contained in sections three and four above, we recommend that the Commission adopt the following criteria for the purpose of the current review.

5.1. Market Structure

We recommend that the Commission consider the following four criteria for its assessment of market structure.

Criteria 1 - Number of Customers and Retailers

We recommend that the Commission identify the number of residential and small business electricity, gas and dual fuel customers and the number of retailers currently supplying, or intending to supply these customers over the coming year.

We note that the Commission's current methodology for identifying the number of retailers under Indicator 1 of its monitoring framework is appropriate for the current review. We therefore recommend that the Commission identify the number of South Australian licensed retailers and the number of retailers supplying large customers¹⁵, residential customers¹⁶ and small business customers⁷, based on information already provided by retailers under current reporting requirements. We also recommend that the Commission identify those retailers that intend to target defined residential and small business customer sub-groups over the coming year, based on information already obtained from retailers or alternatively, information to be collected from retailers over the course of the current review.

Criteria 2 - History of Entry, Exit, Retailer Consolidation and Vertical Integration

We recommend that the Commission outline the history of entry and exit of licensed retailers from 1999 to 2006 and identify any instances of retailer consolidation and vertical integration. This analysis will assist the Commission in forming a view as to whether such behaviour may have improved the efficiency of retailers, or alternatively, increased barriers to new entry or expansion by new entrants.

Criteria 3 - Market Share and Market Concentration

We recommend that the Commission calculate and report the following for the period 2003 - 2006:

¹⁵ Large customers defined as having annual consumption of electricity equal to or greater than 160MWh or annual consumption of gas equal to or greater than 1TJ.

¹⁶ Small residential or business customers defined as having annual consumption of electricity less than 160MWh or annual consumption of gas less than 1TJ.

- § total market share of all retailers for residential and small business electricity, gas and dual fuel customers;
- § market shares for residential and small business electricity, gas and dual fuel customers by location (metropolitan Adelaide and rural and regional South Australia);
- § market shares for residential and small business electricity, gas and dual fuel customers by consumption level (0 – 80 MWh and 80 – 160 MWh for electricity and 0 – 0.5 TJpa and 0.5 – 1 TJpa for gas); and
- § market shares for customers on market contracts only, if possible, by location and consumption level.

We also recommend that the Commission calculate the HHI for each market as a whole, and for each particular sub-market identified above.

We understand that the Commission does not currently have access to data that would allow it to undertake this assessment and that such data may need to be obtained from retailers under the current review.

Criteria 4 - Barriers to Entry and Expansion

We recommend that the Commission identify and evaluate the primary barriers to entry perceived by potential new entrant retailers and any perceived barriers to expansion by retailers that already supply at least one segment of the electricity or gas retail market.

We suggest that this analysis be informed in the first instance by responses received from past retailer surveys with further views elicited from retailers via further consultations as part of the current review. Specific barriers that may be of interest for the purpose of this review include:

- § the extent to which standing contract retailers enjoy economies of scale and scope that restrict the ability of new entrants to expand in the market;
- § the extent to which new entrant retailers have experienced difficulties in negotiating wholesale gas supplies at prices that would allow them to compete with the incumbent, vertically integrated retailer Origin;
- § the extent to which pipeline constraints (contractual or otherwise) may have limited the ability of new entrant gas retailers to offer firm supplies to customers in each major demand centre within South Australia;
- § the extent to which hedging is required for retailers to minimise risk and offer a viable service, and the availability of such hedging products;
- § the impact of the Commission's approach to, and presence of, standing offer retail contract price setting on competition;

- § regulatory requirements or other potential barriers to entry relating to service standard requirements, licensing or other requirements for the supply of energy to retail customers; and
- § the extent to which contract termination fees limit the ability of new retailers to attract customers.

The Commission may also wish to pay particular attention as to the reasons why retailers active in adjoining geographic markets such as Victoria may not have entered the South Australian market.

We note that an assessment of barriers to entry must necessarily take account of the impact of recent and likely future developments such as increased vertical integration and future investment in baseload and peaking generation plant. Such developments could potentially heighten or lessen barriers to entry in retail markets.

5.2. Market Conduct

We recommend that the Commission consider the following five criteria for its assessment of market conduct.

Criteria 5 – Extent of Market Offers made by Retailers

We recommend that the Commission report on the proportion of customers that have been contacted by a retailer with a market offer based on responses to the latest customer survey undertaken under the Commission's monitoring framework.

Criteria 6 – Extent and Type of Marketing Activity undertaken by Retailers

We recommend that the Commission report on the advertising and sales channels used by retailers to encourage customers to switch to market contracts. We recommend that the Commission gather information from retailers in regard to the specific sales channels used and retailer strategies for attracting specific customer classes. This information could then be compared with responses to the latest customer survey regarding the sources of information that customers look to for information about the market contracts offered by retailers.

Criteria 7 – Evidence of Anti-Competitive, Misleading or Deceptive Behaviour by Retailers

We recommend that the Commission consider the number and nature of complaints made to the Energy Industry Ombudsman SA in relation to customer dealings with electricity and gas retailers over the period 2002 to 2005. In conducting this assessment the Commission should take into account customer awareness of the Ombudsman and the increase in the level of retailer marketing activity in conjunction with the number of complaints made.

We recommend that the Commission supplement this analysis with a discussion of customer's experience with retailers, elicited from the latest customer survey.

Criteria 8 – Customer Awareness of Ability to Chose Retailer and the Existence of Other Retailers

We recommend that the Commission assess and report on the results of the latest customer survey regarding customer awareness of their ability to choose their electricity and/or gas retailer and customer awareness of the existence of retailers other than their current supplier. The Commission may assess differences in customer views by type of customer.

Criteria 9 – Customer Views on the Ease of Obtaining and Comparing Information Provided by Retailers in relation to Market Contract

We recommend that the Commission assess and report on the results of the latest customer survey regarding customer views on the ease of obtaining information and the ease of comparing the information supplied by retailers to enable them to chose the most appropriate, cost effective market contract available.

Criteria 10 – Customer Switching

We recommend that the Commission assess the level of customer switching in a more detailed manner than is currently carried out under the Commission's monitoring framework. We recommend that the Commission assess the following for the purpose of the current review:

- § gross switching: the total number of completed small electricity and gas customer retail transfers from 2003 to 2006;
- § net switching: the total number of electricity and gas customers currently allocated to AGL/Origin and other retailers from 2003 to 2006;
- § movement to market contracts: the total number of transfers from AGL/Origin standing offer contracts to market contracts offered by these and other retailers from 2003 to 2006 (as currently reported by the Commission);
- § if possible, the level of gross and net switching and movement to market contracts by geographic location (metropolitan Adelaide and rural and regional South Australia); and
- § if possible, the level of gross and net switching and movement to market contracts by customer type based on consumption levels (0 – 80 MWh and 80 – 160 MWh for electricity and 0 – 0.5 TJpa and 0.5 – 1 TJpa for gas).

The Commission could compare these switching rates with that observed in other jurisdictions, taking into account the time at which FRC was introduced in each jurisdiction.

In addition to the above we recommend that the Commission report on the reasons provided for electricity customer switching as reported by NEMMCO.

We also recommend that the Commission provide details of the likelihood of small customers to switch retailers within the next year, reasons provided in support of the decision to switch (as currently reported under Indicator 5: Price/service mix) and the reasons provided for not switching (as currently reported under Indicator 4: Information asymmetries) based on data from the latest customer survey.

Finally, we recommend that the Commission complete this section with an assessment of the costs that customers would likely incur in terminating contracts with their current retailer.

5.3. Market Performance

We recommend that the Commission consider the following three criteria for its assessment of market performance.

Criteria 11 – Availability of Market Offers at a Discount to the Standing Contract

We recommend that the Commission report on the number of market contracts offered by each retailer, the customer classes to whom these contracts are available and the extent to which these contracts are offered at a discount to the standing contract for a range of consumption profiles.

We also recommend that the Commission supplement this analysis with a review of information obtained from the latest customer survey regarding customer satisfaction with the assistance provided by their retailer and the timeliness of response to customer queries or complaints.

Criteria 12 – Availability of Differentiated Market Contracts with Alternative Price and Non-Price Features, Terms and Conditions

In addition to an assessment of the discount offered under various market contracts, we recommend that the Commission assess the extent to which retailers have introduced innovative product offerings and identify whether such offerings have been made available to all customers or only a subset of customers. Such an assessment will require consideration of the non-price terms and conditions set out in each market contract and may also be informed by responses to the latest retailer survey and/or consultations with retailers.

Criteria 13 – Retailer Performance and Customer Satisfaction with Performance

We recommend that the Commission assess retailer performance against measures already specified under the current reporting regime in South Australia, compare such performance

with retailers in other jurisdictions, namely Victoria, and consider the level of customer satisfaction with retailer performance, and how this may have changed since the introduction of full retail contestability.

Criteria 14 – Impact of Competition on Low-Income Groups

We recommend that the Commission assess the impact that retail competition has likely had on low-income groups, including the extent to which:

- § low-income customers are aware of their ability to switch and the extent to which such awareness differs between low-income and other customers;
- § low-income customers have switched retailers and/or to a market contract with the standing contract retailer, and the extent to which such patterns of switching differ between low-income customers and other customers;
- § the extent to which new entrant retailers target low-income customers based on the results of the latest retailer survey or via consultations with retailers;
- § the market share of retailers for low-income customers based on data from the latest customer survey;
- § the extent to which the market offers of each retailer are available to, or would result in cost savings for low-income customers;
- § if possible, an assessment of the ‘hardship’ baseline, showing:
 - the proportion of households in the bottom 10 – 50% of the distribution of household disposable income that spend more than 6%, 8% and 10% of income on fuel; and
 - the proportion of households in the bottom 10 – 50% of the distribution of household disposable income that, due to a shortage of money, were unable to heat their home.

As per the Commission’s March 2006 Statistical Report, in lieu of available information in regard to the hardship baseline, we recommend that the Commission continue to monitor the change in average annual residential electricity prices and compare this with movements in weekly government allowances and pensions.

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