

# **Review of the performance and competitiveness of the retail electricity market in NSW**

From 1 July 2015 to 30 June 2016

**Energy — Final Report**  
November 2016



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# Contents

<b>1</b>	<b>Executive summary</b>	<b>1</b>
1.1	Competition is working and continues to improve	1
1.2	Why we consider that competition is working	1
1.3	Recent price changes reflect efficient costs	3
1.4	Opportunities to make the market work better	3
1.5	Different views on the state of competition	5
1.6	List of final recommendations and overall finding	6
1.7	What the rest of this report covers	7
<b>2</b>	<b>Context for this review</b>	<b>8</b>
2.1	Our role as Market Monitor	8
2.2	The AEMC's competition review	9
2.3	Uncertainty on future network prices	9
2.4	Climate change policy	11
2.5	Energy security	11
2.6	Submissions on our Draft Report	12
<b>3</b>	<b>Our approach and process</b>	<b>22</b>
3.1	Our approach to the review	22
3.2	Information we considered	23
3.3	Our process for this review	24
<b>4</b>	<b>Barriers to entry, exit and expansion</b>	<b>25</b>
4.1	Overview of our finding	25
4.2	Assessment of barriers to entry, expansion and exit	26
4.3	Number of retailers contesting the market	29
4.4	Market Concentration	30
<b>5</b>	<b>Customer participation and outcomes</b>	<b>32</b>
5.1	Overview of our finding	32
5.2	Assessment of customer participation and outcomes	32
5.3	Customer participation	34
5.4	Customer outcomes	37
<b>6</b>	<b>Price movements in 2015-16</b>	<b>43</b>
6.1	Overview of our finding	43
6.2	Assessment of price changes in 2015-16	44
6.3	Measuring price changes	45

6.4	Changes in underlying costs	52
<b>7</b>	<b>Price movements between June 2016 and September 2016</b>	<b>59</b>
7.1	Overview of our finding	59
7.2	Assessment of price changes between June 2016 and September 2016	60
7.3	Measuring price changes	60
7.4	Retailers' explanations for price changes	66
7.5	Our assessment of changes in underlying costs	67
<b>8</b>	<b>Rivalry and diversity</b>	<b>73</b>
8.1	Overview of our finding	73
8.2	Assessing rivalry and price and product diversity	74
8.3	Retailers' perception of independent rivalry	74
8.4	Price diversity	74
8.5	Product diversity	76
	<b>Appendices</b>	<b>83</b>
A	Price changes in 2015-16	85
B	Price changes from June 2015 to September 2016	91





# 1 Executive summary

This report outlines the Independent Pricing and Regulatory Tribunal's (IPART's) overall finding on the performance and competitiveness of the retail electricity market in NSW between July 2015 and June 2016. In response to a request from the Minister for Industry, Resources and Energy (the Minister), we have also assessed whether price changes from July 2016 are consistent with a competitive market. This is the second annual review we have undertaken in our role as Market Monitor since retail electricity price regulation was removed in NSW from 1 July 2014.

## 1.1 Competition is working and continues to improve

Our overall finding is that competition for residential and small business customers in the NSW retail electricity market is delivering customers greater choice, service innovations and prices consistent with a competitive market. We also consider that the recent price changes retailers announced in July 2016 reflect changes in the underlying market costs of supplying small customers, and are therefore consistent with a competitive market. On the basis of these findings, in our view a detailed review of retail prices and profit margins is not necessary.

## 1.2 Why we consider that competition is working

In the two years since retail electricity price regulation was removed in NSW, market-led product and service innovation and price discounting have provided benefits to customers. We expect these dynamic efficiency benefits to continue.

### 1.2.1 Innovation is increasing

There has been a substantial increase in the range of products and services available to electricity customers over the past two years. Some examples include:

- ▼ integrated solar PV and battery storage plans
- ▼ bundled energy, data and telecommunications plans
- ▼ plans to contribute an agreed fortnightly/monthly fixed amount towards bills
- ▼ options to pre-purchase electricity at discounted rates, and
- ▼ subscription fee pricing that departs from the traditional model of charging per kilowatt of energy usage.

In our view, this innovation is one of the strongest indicators of a competitive market. Retailers are designing products and services to cater for the needs of different customers. Electricity offers are being designed to make it easier for customers to manage their bills, to get more information and control over energy usage, receive real-time price signals and achieve energy self-sufficiency.

### **1.2.2 New retailers continue to enter the market**

Across 2015-16, six new electricity retailer brands entered the NSW market. This is in addition to five retailer brands that became active in 2014-15. The number of smaller retailers in the market has doubled since the removal of price regulation. While the three largest retailers have just over 90% of the small customer market, the trend for smaller retailers to gradually increase their share of the market continued during 2015-16.

The increasing number of retailers competing for customers demonstrates an important feature of the market – ie, relatively low barriers to entry. Incumbent retailers face the continuing threat of competition from new retailers. We consider that this is the most effective form of protection from the exercise of market power.

### **1.2.3 Substantial price discounts are available**

Price discounts are the main way, but not the only way, that retailers attract and retain customers. Our analysis shows there are substantial discounts off standing offer prices available to customers who shop around for a better deal. In September 2016, typical residential customers could save between \$284 and \$445 per annum and typical small business customers could save between \$568 and \$856 per annum by switching from a major retailer's standing offer to the same retailer's best market offer. Many customers are already shopping around, with the retailers' most common residential offers (by number of customers) ranging from \$75 (Ausgrid area) to \$625 (Essential area) per annum cheaper than their standing offers, depending on the network area. The Australian Government's [energymadeeasy.gov.au](http://energymadeeasy.gov.au) website helps customers compare offers and translate percentage discounts into actual bill amounts.

While retail prices increased from July this year, across 2015-16 typical residential bills fell by around 3% to 18% depending on the network area. This decrease was largely the result of falling network prices and other costs remaining fairly stable. We consider that price changes in 2015-16 reflect changes in underlying market costs, and are consistent with outcomes in a competitive market.

### 1.3 Recent price changes reflect efficient costs

In July this year, retailers announced average increases in retail electricity prices of around 7% to 15% on residential standing offers. The Minister asked IPART to consider whether these price changes are consistent with a competitive market.

In a competitive market we expect that price changes would broadly reflect changes in the underlying market costs of supplying electricity. This means that if underlying costs increase we would also expect to see prices increase, even in a competitive market. To inform our assessment we asked retailers to provide us with information on the costs contributing to their price changes. We also commissioned Frontier Economics (Frontier) to identify relevant cost drivers of retail price changes, and to quantify these for an efficient retailer between 2015-16 and 2016-17. Frontier used principles and approaches in line with those IPART used when we regulated electricity prices. These include that retailers set their prices in advance based on expectations of costs, and use publicly available market prices. These resulted in an overall change in the cost of supplying electricity of between 11.0% and 16.7%.

The main cost driver was higher wholesale electricity prices. Wholesale electricity prices have recently increased from historically low levels. The retirement and scheduled maintenance of a number of generators has contributed to these higher wholesale prices. Since NSW is connected to the National Electricity Market (NEM), events that take place in other states may flow through to affect prices in NSW and other regions in the NEM to varying extents. While making up a relatively small proportion of electricity bills, the cost of complying with green schemes and in particular the Large-scale Renewable Energy Target, has also contributed to recent retail price increases. It may be that recent policy uncertainty in relation to the Renewable Energy Target has delayed investment in renewable energy generation and pushed up certificate prices for this scheme.

The information provided to us by retailers is broadly consistent with these cost drivers. These are discussed further in Chapter 7.

### 1.4 Opportunities to make the market work better

While our view is that the NSW retail electricity market is working well, there are still opportunities to make it work better.

#### 1.4.1 Removing unnecessary barriers to entry

Removing unnecessary legal or regulatory barriers to enter the retail market would reduce the costs of entering the retail market. Currently, there are inconsistencies between state-based energy efficiency schemes which present a barrier to entering the market. Many retailers operate under several Australian

jurisdictions, and these inconsistencies mean retailers require greater resources to manage compliance with the schemes. Customers pay for these additional compliance costs.

As energy efficiency is an eligible activity under the Australian Government's Emissions Reduction Fund,<sup>1</sup> the continued operation of state-based schemes may duplicate rather than complement the objectives of this fund. If this is the case, duplicative components of state-based schemes could be wound up and any residual functions that are complementary could be transitioned to a national scheme. This recommendation received support from submissions to our draft report.<sup>2</sup> Clear transition arrangements would need to be put in place to maintain certainty for businesses investing in state-based energy efficiency schemes.

#### 1.4.2 Removing unnecessary regulation

Currently, a component of early termination fees (ETFs) is subject to caps under the National Energy Retail Rules (NSW). In 2013, IPART was asked by the NSW Government to set these caps.<sup>3</sup> Since the majority of market offers now either don't include an ETF, or have ETFs well below these caps, we consider that competition is providing a better form of protection for customers relative to regulation. In our view, regulation of ETFs is no longer needed.

#### 1.4.3 Improving consumer awareness and participation

Customers have a role to play in improving the performance and competitiveness of a market. The more well-informed and engaged customers are, the more pressure there is on retailers to offer competitive prices and services.

Compared to other countries around the world, Australian customers are relatively engaged in the energy market.<sup>4</sup> However, some customers do not participate in the market and miss out on price discounts and other benefits on offer. For some, the cost of their time to search for and switch to a cheaper deal

<sup>1</sup> Australian Government, Department of Environment and Energy, Emissions Reduction Fund, at <https://www.environment.gov.au/climate-change/emissions-reduction-fund>, accessed 5 September 2016.

<sup>2</sup> EnergyAustralia submission to Draft Report, 27 October 2016, p 3; Origin submission to Draft Report, 27 October 2016, pp 3-4; and PIAC, *A competitive market to benefit all – IPART Review of the performance and competitiveness of the retail electricity market in NSW*, 27 October 2016, p 2.

<sup>3</sup> NSW Premier Barry O'Farrell, *Terms of Reference – Investigation and report on requirements in relation to early termination charges to be imposed on retailers under the National Energy Retail Rules (NSW)*, 17 July 2013, at [https://www.ipart.nsw.gov.au/files/sharedassets/website/trimholdingbay/terms\\_of\\_reference\\_-\\_requirements\\_for\\_early\\_termination\\_charges\\_to\\_be\\_imposed\\_on\\_retailers\\_under\\_the\\_national\\_energy\\_retail\\_rules\\_nsw.pdf](https://www.ipart.nsw.gov.au/files/sharedassets/website/trimholdingbay/terms_of_reference_-_requirements_for_early_termination_charges_to_be_imposed_on_retailers_under_the_national_energy_retail_rules_nsw.pdf)

<sup>4</sup> Oxera, *Behavioural insights into Australian retail energy markets – Report for the Australian Energy Market Commission*, 11 March 2016, p 27.

outweighs their potential benefit from a lower bill. For these customers, not participating in the market is a rational choice.

The AEMC found that only one in 10 customers is aware of the Australian Government's energy comparison website [energymadeeasy.gov.au](http://energymadeeasy.gov.au).<sup>5</sup> We support the AEMC's recommendation that the NSW Government promote this website to encourage further customer participation in the retail energy markets.<sup>6</sup>

There are some customers who have difficulty engaging in the market because of language or other barriers. In our view there is an opportunity for retailers to assist these customers, along with targeted government assistance programs such as those already provided by the Ethnic Communities Council of NSW.<sup>7</sup> We also note that the Energy & Water Ombudsman NSW (EWON) provides information in several languages to help customers search for and find better energy offers.<sup>8</sup>

## 1.5 Different views on the state of competition

Some take the view that 'if you pay more because you don't shop around, the market isn't working'. We consider that if you can pay a lower price by shopping around, the market *is* working. A number of competitive markets demonstrate this. For example, customers can make substantial savings by shopping around when buying flights, consumer electronics, insurance, cars and mobile plans.

Because customers respond to prices differently, ie, have different demand elasticities, there will inevitably be price differentials in the market. We consider these price differentials is a sign that the market is working, and support innovation and dynamic efficiency. By some customers paying more than they need to, retailers are able to offer lower prices to others who do shop around.

### 1.5.1 A caution against intervention in the market

As noted in section 1.2, in the two years since prices were deregulated in NSW we have seen substantial innovation and continued price discounting delivering benefits to customers.

The existence of price differentials and concern over lack of customer engagement has led some governments and regulators to intervene in the market. This was the case in the UK energy market, where Ofgem introduced requirements to remove price differentials that were not based on costs and limit

<sup>5</sup> Newgate Research, *Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets*, June 2016, p 109.

<sup>6</sup> AEMC, *2016 Retail Competition Review – Final Report*, 30 June 2016, pp iv-v.

<sup>7</sup> See <http://www.eccnsw.org.au/What-we-do/Advocacy.aspx>, accessed 6 September 2016.

<sup>8</sup> EWON, <https://www.ewon.com.au/page/customer-resources/switching-retailers>, accessed 25 November 2016.

the number of tariffs that retailers can offer. While well-meaning, this intervention actually resulted in less innovation, reduced competition and overall made customers worse off.<sup>9</sup>

A report by Oxera for the Australian Energy Market Commission (AEMC) discusses behavioural biases that may reduce customers' interest in and engagement with the energy market. These behavioural biases do not necessarily result in worse customer outcomes and in many cases result in customers making prudent, cautious decisions. The report recommends that if policy changes are being considered to increase customer engagement, for example changes to the format, content or frequency of information provided to energy customers, they should be first tested to see whether they work with or against identified biases.<sup>10</sup>

## 1.6 List of final recommendations and overall finding

### IPART overall finding

- 1 That competition for residential and small business customers in the NSW retail electricity market is working well, and that a detailed review of retail prices and profit margins is not necessary.

### Final recommendations

- 1 That, to reduce the barriers for small retailers entering the NSW retail electricity market, the NSW Government wind down duplicative components of state-based green energy and energy efficiency schemes, with the option to transfer any residual functions that are complementary to a national scheme such as the Emissions Reduction Fund. (This would be a similar process to the winding down of the NSW Greenhouse Gas Reduction Scheme (GGAS) in June 2012). Clear transition arrangements would need to be put in place to maintain certainty for businesses investing in state-based energy efficiency schemes. 28
- 2 That price regulation of early termination fees caps under the National Energy Retail Rules (NSW) be removed as the competitive market is providing a more effective means of protecting customers. 81

<sup>9</sup> Competition & Markets Authority, *Energy market investigation – Summary of final report*, June 2016, pp 41-42.

<sup>10</sup> Oxera, *Behavioural insights into Australian retail energy markets – Report for the Australian Energy Market Commission*, March 2016, p 3.

## 1.7 What the rest of this report covers

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

- ▼ Chapter 2 provides some context for our review and outlines what we have been asked to do. It also discusses some developments in the retail electricity market that are relevant to our review.
- ▼ Chapter 3 describes our process and approach to the review.
- ▼ Chapter 4 provides our findings on the structure of the market and the barriers to entry, expansion and exit from the market.
- ▼ Chapter 5 provides our final findings on customer participation and outcomes in the market.
- ▼ Chapter 6 contains our analysis of price movements over 2015-16.
- ▼ Chapter 7 contains our analysis of price movements from July 2016.
- ▼ Chapter 8 provides our findings on rivalry between retailers and the extent of product and price diversification in the market.
- ▼ The appendices provide supporting information.



## 2 Context for this review

The NSW Government decided to remove retail electricity price regulation effective 1 July 2014.<sup>11</sup> As part of its decision to deregulate, the NSW Government gave IPART a new role to monitor and report annually on competition in the retail electricity market.

This is our second annual report on the performance and competitiveness of the retail electricity market for residential and small business customers. Last year we found that competition for residential and small business customers in the NSW retail electricity market was working well, and that a detailed review of retail prices and profit margins was not necessary.<sup>12</sup>

This chapter outlines our role as Market Monitor, and summarises recent developments in the retail electricity market that are relevant to our review.

### 2.1 Our role as Market Monitor

Our role as Market Monitor is set out in the *National Energy Retail Law (NSW)* (the Act).<sup>13</sup> The Act calls for the Market Monitor to report annually to the Minister on the performance and competitiveness of the retail electricity market in NSW, including:

- ▼ the participation of small customers in the market and, if the Market Monitor thinks it appropriate, particular groups of small customers
- ▼ prices of electricity for small customers in regional areas
- ▼ any barriers to entry to or exit from, or expansion in the market
- ▼ the extent to which retailers are competing to attract and retain small customers

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<sup>11</sup> See NSW Resources & Energy website, <http://www.resourcesandenergy.nsw.gov.au/energy-consumers/energy-sources/electricity/removal-of-electricity-price-regulation>, accessed 16 September 2016.

<sup>12</sup> IPART, *Review of the performance and competitiveness of the retail electricity market in NSW - From 1 July 2014 to 30 June 2015 - Final Report*, November 2015, p 1.

<sup>13</sup> *National Energy Retail Law (NSW)*, s 234A. IPART is prescribed by the NSW regulations as the Market Monitor for the purpose of Part 9A of the Act (*National Energy Retail Law (Adoption) Regulation 2013*, cl 8A).



- ▼ whether price movements and price and product diversity in the market are consistent with a competitive market
- ▼ if the Market Monitor is of the opinion that it is required, steps necessary to improve the competitiveness of the market
- ▼ whether there is a need for a detailed review of retail prices and profit margins in the market (ie, 'special review'), and
- ▼ any other matters the Market Monitor thinks appropriate.

As indicated above, our review relates to small customers, which include residential and small business customers.<sup>14</sup>

### 2.1.1 Assessing price changes from July 2016

Our market monitoring reports look at the performance and competitiveness of the retail electricity market over the previous financial year. This year, in response to a request from the Minister, we have also assessed whether price changes from July 2016 are consistent with a competitive market. This analysis is outlined in Chapter 7.

## 2.2 The AEMC's competition review

The AEMC also conducts annual reviews of competition in retail energy markets, both in NSW and other jurisdictions. The latest review concluded in June 2016 and found that competition continues to be effective in the NSW retail electricity market, with some signs of increasing competition since prices were deregulated in 2014.<sup>15</sup> The AEMC undertakes surveys of energy customers and retailers as part of its review. We refer to these surveys in various sections of this report.

## 2.3 Uncertainty on future network prices

The costs of using the electricity network makes up around half of a retail electricity bill.<sup>16</sup> Changes in network prices therefore have a substantial influence on the overall change in retail electricity prices. Network prices are regulated by the Australian Energy Regulator (AER).

<sup>14</sup> Generally, small customers consume less than 100 megawatt hours per annum.

<sup>15</sup> AEMC, *2016 Retail Competition Review – Final Report*, 30 June 2016, p 19.

<sup>16</sup> Frontier Economics, *Cost drivers of recent retail electricity prices for small retail customers – A final report prepared for IPART*, November 2016, p 27.

In April 2015, the AER released its final decisions on the maximum revenues that the three electricity distribution network businesses in NSW (Ausgrid, Endeavour Energy and Essential Energy) would be allowed to earn over the 2014-19 regulatory period.<sup>17</sup> Following these decisions, on 1 July 2015 there was a material reduction in network prices for residential and small business customers across all network areas. This is discussed further in Chapter 6.

All three network businesses applied to the Australian Competition Tribunal for merits review of the AER's decisions.<sup>18</sup> On 26 February 2016, the Australian Competition Tribunal handed down its decision, which was to set aside the AER's decisions. On 24 March 2016, the AER applied to the Federal Court for judicial review of the Australian Competition Tribunal's decision.<sup>19</sup> Network prices for 2016-17 were determined through the AER accepting an enforceable undertaking from each of the network businesses, with network prices remaining fairly stable.

There is uncertainty over how the AER and the networks will implement the Federal Court's ruling when it is made. If the decision reverses some or all of the price reductions already implemented, there may need to be substantial network price changes in future years. This has prompted a rule change request as outlined below.

### 2.3.1 Proposed rule change to reduce network price volatility

Ausgrid, Endeavour Energy and Essential Energy recently submitted a rule change request to the AEMC aimed at reducing potential network pricing volatility. The proposed rule change would enable a specified portion of any adjustment amount (positive or negative) to be recovered over two regulatory control periods. In the absence of a rule change, any adjustment amount must be recovered in the current regulatory control period. This may lead to substantial pricing volatility for NSW customers given the limited time left to recover the adjustment amount in the current regulatory control period.<sup>20</sup>

In August 2016 the Council of Australian Governments (COAG) Energy Council tasked its Senior Committee of Officials to review by 1 December 2016 the

<sup>17</sup> <https://www.aer.gov.au/news-release/aer-expects-final-decisions-to-lower-electricity-bills-for-act-and-nsw-customers>, accessed 16 September 2016. Note that the 2014-19 regulatory control period was separated into a transitional control period from 1 July 2014 and 30 June 2015 and a subsequent regulatory control period from 1 July 2015 to 30 June 2019.

<sup>18</sup> [http://www.competitiontribunal.gov.au/\\_\\_data/assets/pdf\\_file/0003/30666/Summary-AER-Review-Decisions-26-Feb-2016.pdf](http://www.competitiontribunal.gov.au/__data/assets/pdf_file/0003/30666/Summary-AER-Review-Decisions-26-Feb-2016.pdf), accessed 16 September 2016.

<sup>19</sup> <https://www.aer.gov.au/news-release/aer-appeals-against-electricity-and-gas-price-decisions>, accessed 16 September 2016.

<sup>20</sup> For information on the rule change request, see <http://www.aemc.gov.au/Rule-Changes/Participant-derogation-NSW-DNSPs-Revenue-Smoothing>, accessed 13 September 2016.

effectiveness of the limited merits review regime under the National Electricity and Gas laws.<sup>21</sup>

## 2.4 Climate change policy

The Climate Change Authority (CCA) recently released a report making recommendations on Australia's climate change policies.<sup>22</sup> The recommendations are designed to deliver on the commitments that flow from the United Nations Framework Convention on Climate Change (UNFCCC) Paris conference held in late 2015.

The CCA recommended a policy toolkit that uses current measures like the Emissions Reduction Fund and the safeguard mechanism, as well as new measures. For policy stability and certainty, the CCA recommended the Renewable Energy Target (RET) should remain in place. It also recommended that an emissions intensity scheme be introduced for electricity generators in 2018. The scheme would set an emissions intensity baseline for the sector, reaching zero well before 2050. Generators could purchase credits from energy efficiency projects to help meet their baseline obligations.<sup>23</sup>

While the report only makes recommendations, any change in climate change policy has the potential to change the cost of electricity. The costs of the existing climate change policies, including the RET, are discussed in Chapter 6. We will continue to monitor climate change policy as part of our annual reviews.

## 2.5 Energy security

In October 2016 the COAG Energy Council commissioned an independent review to take stock of the current state of the security and reliability of the national electricity market and provide advice to governments on a coordinated, national reform blueprint.<sup>24</sup>

The review will draw together and build on recent and ongoing work streams, including by the Australian Energy Market Operator, the Australian Energy Market Commission, the Australian Energy Regulator and gas market reforms.<sup>25</sup>

<sup>21</sup> COAG Energy Council, *Limited Merits Review Terms of Reference*, August 2016, at <http://www.coagenergycouncil.gov.au/publications/limited-merits-review-terms-reference-august-2016> accessed 11 November 2016.

<sup>22</sup> Climate Change Authority, *Towards a Climate Policy Toolkit: Special review of Australia's climate goals and policies*, August 2016.

<sup>23</sup> Ibid, pp 3-8.

<sup>24</sup> COAG Energy Council, *Meeting Communique*, 7 October 2016, at <http://www.scer.gov.au/sites/prod.energycouncil/files/publications/documents/Energy%20Council%20Communique%20-%207%20October%202016.pdf> accessed 11 November 2016.

<sup>25</sup> Ibid.

In light of this body of work in 2016, the Australian Government's commitment at Paris and the integration of climate and energy policy at the federal level, the blueprint will outline national policy, legislative, governance and rule changes required to maintain the security, reliability, affordability and sustainability of the national electricity market. A preliminary report will be prepared for the COAG Leaders' Meeting in December with a final report early in the new year.<sup>26</sup>

## 2.6 Submissions on our Draft Report

We received six submissions on our Draft Report. Submissions from the Australian Energy Council (AEC), Origin Energy, Energy Australia and AGL supported our findings that competition is working and is delivering greater choice and better price outcomes for customers.<sup>27</sup> The Public Interest Advocacy Centre (PIAC) submitted that the market is not yet delivering what deregulation set out to achieve, and that the market is not effectively competitive if not all consumers are able to engage meaningfully with the market.<sup>28</sup> Bruce Mountain of Carbon Market Economics (CME) provided some comments on our Draft Report and compared estimated retail charges in NSW with those in Europe.<sup>29</sup>

In this section we summarise the submissions we received, and respond to the issues raised.

### 2.6.1 Barriers to entry, exit and expansion

We found that there are relatively low barriers to entry, expansion and exit in the NSW retail electricity market. Six new retail brands entered the market during 2015-16, in addition to five retailer brands that became active in 2014-15. However, we recommend removing barriers resulting from inconsistencies between the various state-based green energy and energy efficiency schemes as well as duplication with federal schemes. Origin Energy and EnergyAustralia both supported this recommendation.<sup>30</sup>

PIAC agrees that duplication between state and federal schemes increases costs for consumers, and supports our recommendation, subject to careful analysis of impacts on low-income households.<sup>31</sup>

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<sup>26</sup> Ibid.

<sup>27</sup> Energy Council submission to Draft Report, 27 October 2016; AGL submission to Draft Report, 27 October 2016; EnergyAustralia submission to Draft Report, 27 October 2016; and Origin submission to Draft Report, 27 October 2016.

<sup>28</sup> PIAC, *A competitive market to benefit all – IPART Review of the performance and competitiveness of the retail electricity market in NSW*, 27 October 2016, p 2.

<sup>29</sup> Bruce Mountain submission to Draft Report, 7 October 2016.

<sup>30</sup> EnergyAustralia submission to Draft Report, 27 October 2016, p 3; and Origin submission to Draft Report, 27 October 2016, pp 3-4.

<sup>31</sup> PIAC, *A competitive market to benefit all – IPART Review of the performance and competitiveness of the retail electricity market in NSW*, 27 October 2016, p 4.

We also recommend removing unnecessary regulation, such as the setting of caps for early termination fees (ETFs). PIAC does not support this recommendation, and argues instead that ETFs should be banned altogether. If ETFs are not banned, PIAC considers the caps should remain as a safety net for consumers.<sup>32</sup>

Since the majority of market offers now either do not include an ETF, or have ETFs well below the current caps, we consider that competition is providing a better form of protection for customers. We also consider that banning ETFs would reduce choice for consumers unnecessarily. Similar to mobile and internet providers, electricity retailers often offer better tariffs to customers who are willing to commit for a minimum period. Banning ETFs would give retailers no incentive to make such offers available.

We therefore maintain our recommendation that regulation of ETFs should be discontinued. Submissions from EnergyAustralia and AGL support this recommendation.<sup>33</sup>

## 2.6.2 Customer participation and outcomes

AEMC's 2016 review of electricity retail competition found that many customers are shopping around for energy deals, with 32% of residential and 28% of small business customers having actively investigated options during 2015-16. Customers were also found to be relatively satisfied with the market outcomes, with 62% of residential customers saying they were satisfied with the level of market choice and 73% were satisfied with their current retailer.<sup>34</sup> EWON received 27% fewer complaints about electricity retailers in 2015-16 compared with 2014-15.<sup>35</sup>

### Customer participation and switching rates

PIAC submitted that the market is not effectively competitive if not all consumers are able to engage meaningfully with the market, and that the barrier to engagement is higher for certain customer groups, such as those from non-English speaking backgrounds. PIAC also argues that high switching rates is not an indicator of effective competition if barriers to customer engagement still exist.<sup>36</sup> Further PIAC recommended that IPART broaden the set of indicators used to assess the effectiveness of competition, to include customer satisfaction customer engagement and price impacts on vulnerable customers.

<sup>32</sup> PIAC, *A competitive market to benefit all – IPART Review of the performance and competitiveness of the retail electricity market in NSW*, 27 October 2016, p 5.

<sup>33</sup> EnergyAustralia submission to Draft Report, 27 October 2016, p 3; and AGL submission to Draft Report, 27 October 2016, p 1.

<sup>34</sup> AEMC, *2016 Retail Competition Review – Final Report*, 30 June 2016, pp 19-20.

<sup>35</sup> EWON, *Annual Report 2015/16*, at <https://www.ewon.com.au/page/publications-and-submissions/annual-reports/2015-16> accessed 10 November 2016.

<sup>36</sup> PIAC, *A competitive market to benefit all – IPART Review of the performance and competitiveness of the retail electricity market in NSW*, 27 October 2016, pp 2-3.

Our Draft Report provided analysis on customer participation and outcomes and we concluded that most small retailer customers in NSW are aware of choices in the retail market. We agree with PIAC's view that strong consumer participation is essential to ensuring that competition in the market remains effective.

We note the low awareness of the [energymadeeasy.gov.au](http://energymadeeasy.gov.au) website, and we support the AEMC's recommendation that the NSW Government raise awareness of this website. The AEMC recommends that the Government also consider ways to:<sup>37</sup>

- ▼ increase customer understanding of the link between energy use and costs, the benefits of shopping around regularly, and the concessions and support services available,
- ▼ inform customers of the benefits of costs of new products and services to assist them make informed decisions,
- ▼ tailor communications to different audiences, as suggested in the AEMC's report to the Government on consumer engagement,<sup>38</sup> and
- ▼ target vulnerable customers who are not engaged with the energy market or support services

EWON, as well as consumer and community organisations such as Choice, the Ethnic Community Council (ECC) and St Vincent de Paul Society, also play an important role in lowering barriers and encouraging customers to participate in the retail energy markets.

While we agree with PIAC's comment that high switching rates is not by itself an indicator of effective competition, we consider that high switching rates is a good indication that switching retailers is reasonably easy. Low barriers to switching in turn creates an incentive for retailers to offer lower prices, more varied products and better service to retain and acquire new customers. In its 2015-16 annual report on the performance of the retail energy market, the AER noted that switching rates in NSW have stabilised, and that this may be due to retailers shifting their focus away from customer acquisition and towards customer retention. It also noted that the flat switching rates and the increasing proportion of customers on market retail offers may indicate that more customers on standing offers are benefitting by taking up the option of a market offer with their existing retailer.<sup>39</sup>

Further, as competition in the retail market continues to strengthen, customers' searching and switching costs would be expected to continue to reduce as retailers will strive to make their offers as visible and easy to access as possible. In addition to the [energymadeeasy.gov.au](http://energymadeeasy.gov.au) website, retailers can also achieve this

<sup>37</sup> AEMC, *2016 Retail Competition Review – Final Report*, 30 June 2016, pp iv-v.

<sup>38</sup> AEMC, *Supplementary Report: Increasing Consumer Engagement – Review of Competition in the Retail Electricity and Natural Gas Markets in New South Wales*, October 2013.

<sup>39</sup> AER, *Annual Report on the Performance of the Retail Energy Market – 2015-16*, pp 16-18.



through commercial comparator websites. In its report for GetUp!, CME notes that commercial switching sites only include offers from a subset of retailers.<sup>40</sup> Notwithstanding the commercial nature of these websites, they can assist in encouraging customers to engage in the energy market, and can also offer substantial savings to customers that might not otherwise have switched retailer. We also consider that as more customers use these commercial switching sites, competition between retailers on these platforms will also intensify, with the range and value of offers available improving over time.

### Value for money

The recent consumer survey by Energy Consumers Australia (ECA) found that more than half of customers in NSW rated overall value for money for electricity services as positive (seven or more out of ten), which is higher than in any other state.<sup>41</sup> However, in its submission PIAC highlighted that this leaves around half that do not believe they are getting value for money. Mr Mountain echoed this view in his submission, referring to the same survey by ECA.<sup>42</sup>

Mr Mountain also refers to the report by Newgate Research to the AEMC, stating that Newgate Research found 80% of customers rated value for money at four out of ten or higher.<sup>43</sup> In fact, Newgate Research found that 64% of residential customers rated value for money as good to excellent (seven or more out of ten), and another 26% rated value for money as fair (four to six out of ten). Only 7% of residential customers rated value for money as poor (zero to three out of ten).<sup>44</sup> The ECA findings were not as positive in terms of value for money, but 52% of households still rated value for money positively (seven or more out of ten), while 40% of households gave a neutral rating (four to six out of ten), and 8% of households rated value for money negatively (zero to three).<sup>45</sup>

We consider these are reasonably positive outcomes. We also note that the satisfaction indicators tracked by Newgate Research have consistently improved since the electricity retail market was deregulated,<sup>46</sup> and complaints to the ombudsman have declined significantly. These are the sort of outcomes that would be expected in competitive markets, where retailers compete for customers by offering lower prices, a greater variety of products and better service. The Australian Energy Council also emphasises this point in its submission, stating that “competition in retail energy markets, as in other sectors

<sup>40</sup> CME, *Australia's retail electricity markets: who is serving whom? – A report prepared for GetUp!*, August 2016, p 10.

<sup>41</sup> ECA, *Energy Consumer Sentiment Survey Findings*, July 2016, p 3.

<sup>42</sup> Bruce Mountain submission to Draft Report, 7 October 2016, p 1.

<sup>43</sup> Bruce Mountain submission to Draft Report, 7 October 2016, p 1.

<sup>44</sup> Newgate Research, *Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets – Report to AEMC*, June 2016, p 121.

<sup>45</sup> ECA, *Energy Consumer Sentiment Survey Findings – New South Wales*, July 2016, pp 2-3.

<sup>46</sup> Newgate Research, *Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets – Report to AEMC*, June 2016, pp 119-122.

of the Australian economy, incentivises businesses to improve service, develop products that meet consumer needs and find ways to lower their costs so they remain competitive.”<sup>47</sup>

### Vulnerable customers

In their submissions, both PIAC and Mr Mountain refer to a recent report by Choice, which found that the cost of electricity remains the number one concern for 81% of consumers across Australia.<sup>48</sup> PIAC also submitted that the number of customers on payment plans increased from 58,324 in March 2014 to 85,636 in March 2016.<sup>49</sup>

We recognise that the cost of energy is a concern for many, and that some customer groups are particularly vulnerable to difficulties in relation to their ability to pay utility bills. In its research into vulnerable customers, the AEMC found that many vulnerable customers do not participate in the market, and are therefore forgoing savings that they could otherwise put toward other important needs.<sup>50</sup> Section 5.4.4 provides more information on AEMC’s findings in relation to vulnerable customers.

We consider the competitive retail market is well suited to respond to customers’ need to manage their budgets, with some retailers offering fixed-price products or the ability to pre-purchase energy. With the rising adoption of smart-meters, retailers are also increasingly offering apps that allow customers to monitor their energy usage in real-time.

As is the case for all customers, vulnerable customers tend to have low awareness of government run energy comparison websites like [energymadeeasy.gov.au](http://energymadeeasy.gov.au). Again, we support AEMC’s recommendations regarding measures to improve awareness and understanding of energy options among customers, including measures targeted specifically at vulnerable customers.

For customers that are experiencing difficulties paying their energy bills, there are a range of assistance schemes provided by the Government and community organisations. These are in addition to payment-plans and hardship programs offered by all retailers. EWON provides a comprehensive list of assistance available on <https://www.ewon.com.au/page/customer-resources/help-paying-bills>, and EWON can also provide free advice to customers. However, as noted by the AER, while concessions represent an important saving for eligible

<sup>47</sup> Energy Council submission to Draft Report, 27 October 2016, p 1.

<sup>48</sup> Choice, *Consumer Pulse: Australian’s Attitudes to Cost of Living 2015-2016*, July 2016, p 4.

<sup>49</sup> PIAC, *A competitive market to benefit all – IPART Review of the performance and competitiveness of the retail electricity market in NSW*, 27 October 2016, p 2.

<sup>50</sup> AEMC, *2016 Retail Competition Review – Final Report*, 30 June 2016, p 46.



households, for many households there are significant savings to be achieved just by switching to a cheaper offer.<sup>51</sup>

### 2.6.3 Price movements

We found that retail electricity prices for residential and small business customers generally fell in 2015-16, but increased from around July this year. We also found that these price changes have largely corresponded to changes in the cost of supplying energy, which is consistent with a competitive market.

This finding was supported in submissions.<sup>52</sup> EnergyAustralia comments that:<sup>53</sup>

Effective competition provides a strong incentive for retailers to manage costs so that customers, IPART and the NSW Government can be confident that these price changes broadly reflect changes in the underlying market costs of supplying electricity. Furthermore, customers will continue to benefit from retailers initiatives to better manage costs driven by effective competition.

PIAC suggests in its submission that the strongest indicator of the effectiveness of competition is whether consumers are paying lower prices.<sup>54</sup> We agree that in a competitive market, prices would be expected to be lower than if the market was *not* competitive, since higher profit margins would be competed away. However, if the underlying costs of supply were to rise, retail prices would be expected to reflect these cost increases. Our analysis in chapters 6 and 7 shows that the retail price movements are as expected in a competitive market.

### Standing offers versus market offers in NSW

In his submission, Mr Mountain highlights that standing offer prices by the Big Three retailers are significantly higher than other offers available to customers in NSW. He raises the question of whether there might be other factors than indifference that keeps 27% of household customers in NSW on standing offers (as of March 2016), given the large savings that these households could make by switching.<sup>55</sup>

As noted previously, we consider a greater range of prices available in the market is a sign of competition working. This view is supported by a recent report into the European electricity and gas markets by the Agency for the Cooperation of Energy Regulators (ACER) and the Council of European Energy

<sup>51</sup> AER, *Annual Report on the Performance of the Retail Energy Market – 2015-16*, November 2016, p 52.

<sup>52</sup> Energy Council submission to Draft Report, 27 October 2016; EnergyAustralia submission to Draft Report, 27 October 2016; AGL submission to Draft Report, 27 October 2016; and Origin submission to Draft Report, 27 October 2016.

<sup>53</sup> EnergyAustralia submission to Draft Report, 27 October 2016, p 2.

<sup>54</sup> PIAC, *A competitive market to benefit all – IPART Review of the performance and competitiveness of the retail electricity market in NSW*, 27 October 2016, p 2.

<sup>55</sup> Bruce Mountain submission to Draft Report, 7 October 2016, pp 3-4.

Regulators (CEER). Their report shows that retail energy markets where liberalisation is more mature perform better in terms of the ACER Retail Competition Index (ARCI), and are characterised by a larger number of offers and greater price dispersity. The report also notes that retail competition is not exclusively related to price elements, and that the larger number of offers reflects greater diversity and innovation in product offerings, brought about by market liberalisation.<sup>56</sup>

By offering higher-margin products to customers that are less concerned about price rather than non-price elements, retailers are in turn able to offer lower-priced products to the more price sensitive customers.

In terms of the share of households that remain on standing offers, it has declined from nearly 40% in March 2014 to around 27% in March 2016. When customers were recently asked by Newgate Research and by the ECA why they had not considered switching (or not switched after investigating options), the most common response was that they were happy with their current retailer or deal.<sup>57</sup> A significant number of customers also thought it would be too time consuming, too much hassle or would not make a difference to price.<sup>58</sup> For some, the cost of their time to search for and switch to a cheaper deal outweighs their potential benefit from a lower bill. For these customers, not participating in the market is a rational choice.

The potential savings to customers from switching from one of the Big Three's standing offers was a key message in our Draft Report, and again in this report. We encourage customers to use the Australian Government's energy comparison website [energymadeeasy.gov.au](http://energymadeeasy.gov.au) to find offers that deliver better price or other features that might appeal to some customers.

### Retail charges in NSW compared with other states

Mr Mountain's submission refers to a finding in his CME report for GetUp! which compared estimates of the retail charges in the different states. In his submission he says he finds it "notable that the retailer charges on the cheapest offers in New South Wales are not lower than the retailer charge on the regulated tariffs in the ACT". He suggests this could partly be explained by higher search and marketing costs in deregulated markets.<sup>59</sup>

<sup>56</sup> ACER/CEER, *Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets in 2014*, November 2015, pp 58-61 and 86.

<sup>57</sup> ECA, *Energy Consumer Sentiment Survey Findings*, July 2016, p 7; and Newgate Research, *Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets*, June 2016, p 99.

<sup>58</sup> Newgate Research, *Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets*, June 2016, p 99.

<sup>59</sup> Bruce Mountain submission to Draft Report, 7 October 2016, p 2.

PIAC also refers to findings in CME's report for GetUP! that "the Big Three are charging two to three times more to sell electricity in NSW, VIC, SA and QLD than the regulated retailer in the ACT is charging".<sup>60</sup> PIAC considers this finding calls for an in-depth review of retail prices and profit margins.<sup>61</sup>

In the report for GetUP!, CME presents estimates of retail charges for various market offers in NSW and other states, as well for the regulated offer in ACT. His estimates of the retailer charges on offers from the Big Three are higher than his estimate of the retailer charge on the regulated offer in ACT. The report questions whether the deregulated markets in Australia are delivering outcomes that might be expected in competitive retail markets.<sup>62</sup>

We note that the CME report's estimate of the retailer charge on the average of the three best offers in NSW is significantly lower than the retailer charge on the ACT regulated offer.<sup>63</sup> This suggests that customers that engage with the market in NSW can benefit from retail competition and find offers with lower retailer charges than in the regulated market in the ACT. As noted previously, we also consider a greater range of prices (and products) available in the market is a sign of competition working, reflecting differences in the products being offered by retailers. In addition, when less price-sensitive customers remain on higher-margin products, other customers are able to benefit from cheaper offerings.

We consider the findings by the ECA also support the benefits of retail competition in NSW. Customers gave positive ratings on key indicators in NSW and the ACT as follows:<sup>64</sup>

- ▼ Value for money: 52% in NSW compared with 48% in the ACT.
- ▼ Customer service: 55% in NSW compared with 50% in the ACT.
- ▼ Billing and account options: 62% in NSW compared with 56% in the ACT.

The fact that retail prices have tended to move closely with changes in the underlying costs of supply suggests that retail competition in NSW is working.

<sup>60</sup> CME, *Australia's retail electricity markets: who is serving whom? – A report prepared for GetUP!*, August 2016, p 23 referenced in PIAC, *A competitive market to benefit all – IPART Review of the performance and competitiveness of the retail electricity market in NSW*, 27 October 2016, p 5.

<sup>61</sup> PIAC, *A competitive market to benefit all – IPART Review of the performance and competitiveness of the retail electricity market in NSW*, 27 October 2016, p 6.

<sup>62</sup> CME, *Australia's retail electricity markets: who is serving whom? – A report prepared for GetUP!*, August 2016, pp 2-4.

<sup>63</sup> CME, *Australia's retail electricity markets: who is serving whom? – A report prepared for GetUP!*, August 2016, p 21.

<sup>64</sup> ECA, *Energy Consumer Sentiment Survey Findings*, July 2016, p 3. In response to the question "Thinking about the reliability of your electricity supply, how satisfied are you with the number of times you've had loss of power, blackouts or other faults with your electricity supply in the past 6 months?", 82% of ACT customers responded positively compared with 72% in NSW. We note that retailers have little influence over the reliability of power supply. Source: ECA, *Energy Consumer Sentiment Survey*, July 2016, p 9.

### Retailer charges in NSW compared with in Europe

In his submission, Mr Mountain also compares estimates of electricity retail charges in NSW with those in Europe.<sup>65</sup> The retail charges includes the costs faced by retailers in supplying electricity to customers, along with a margin, and is often referred to as the 'gross retail margin'.

Mr Mountain estimates that the retail charges in NSW are high compared with the average retail charges in European countries. In particular, he highlights the retail charges on standing offers from the Big Three retailers as being 'remarkably high' and notes that retail charges on the cheapest offers from the Big Three retailers is still higher than the estimated average retail charges in the European countries in his comparison. He also points out that the estimated retail charge on the average of the two lowest offers (from different retailers) is noticeably lower than the estimated retail charge on the cheapest offers from the Big Three retailers. On the basis of these findings, Mr Mountain questions whether the differences are driven by costs or profits, and if its profits, whether competition in the NSW electricity retail market is effective.<sup>66</sup>

We consider the findings may have been different had the analysis accounted for each country's relative price level (ie, purchasing power). Mr Mountain submits that using the OECD's 2015 Purchasing Power Parity exchange rate would make little difference to the analysis, since it is close to the Euro exchange rate applied in the analysis.<sup>67</sup> However, this does not account for variations in price and wage levels *within* the Eurozone. For example, comparative price levels calculated by the OECD for 2015 suggests that prices in Germany and Poland would need to be inflated by 29% and 136% respectively before they could be meaningfully compared with prices in Australia.<sup>68</sup>

#### 2.6.4 Rivalry and diversity

We found that there is evidence of both strong rivalry between retailers and a substantial increase in the range of products and services available to customers. In our view this is consistent with competitive market that is working well.

Submissions support this view.<sup>69</sup> The Energy Council notes:<sup>70</sup>

Deregulated prices encourages retailers to design products and services to cater for the needs of different customers. Electricity offers now make it easier for customers to

<sup>65</sup> Bruce Mountain submission to Draft Report, 7 October 2016, pp 2-6.

<sup>66</sup> Bruce Mountain submission to Draft Report, 7 October 2016, pp 2-6.

<sup>67</sup> Bruce Mountain submission to Draft Report, 7 October 2016, p 4.

<sup>68</sup> OECD Stats, at <http://stats.oecd.org/Index.aspx?DataSetCode=PPPGDP> accessed 8 November 2016.

<sup>69</sup> Energy Council submission to Draft Report, 27 October 2016; EnergyAustralia submission to Draft Report, 27 October 2016; AGL submission to Draft Report, 27 October 2016; and Origin submission to Draft Report, 27 October 2016.

<sup>70</sup> Energy Council submission to Draft Report, 27 October 2016, p 1.

manage their bills, to get more information and control over energy usage, receive real-time price signals and achieve energy self-sufficiency.

EnergyAustralia also highlights that recent and forthcoming regulatory initiatives, most notably customer access to data, competition in metering and more cost reflective network tariffs will combine with technological changes to build on the trend of increasing product and service diversity.<sup>71</sup>

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<sup>71</sup> EnergyAustralia submission to Draft Report, 27 October 2016, p 2.

## 3 Our approach and process

To conduct the 2016 annual review, we used an analytical approach that ensures we address all the matters we are required to consider, and had regard to the information specified in the Act. We followed a review process that involved public consultation as well as analysis.

### 3.1 Our approach to the review

The approach we used to make our overall finding includes the following five steps:

1. Considering the requirements of the Act and other contextual factors outlined in Chapter 2 to ensure we understand the matters we must take into account for our review.
2. Defining the retail electricity market as a single market with three distinct network areas (including the Ausgrid, Endeavour Energy and Essential Energy network areas).
3. Collecting and analysing information on competition ‘indicators’ including:
  - barriers to entering, expanding and exiting the market
  - customer participation and outcomes
  - price movements (including prices in regional areas), and
  - the extent of rivalry between retailers including price and product diversity.
4. Making an assessment on the performance and competitiveness of the NSW retail electricity market, considering the findings for all indicators and comments made by stakeholders in their submissions to our review.
5. Considering whether there are any actions needed to improve the competitiveness of the market, and if a special review of retail prices and profit margins in the market is required.

More information on how we have assessed each of the competition indicators is provided in subsequent chapters of this report.

### 3.2 Information we considered

The Act outlines the information we can have regard to in preparing our report, which is limited to the following:

- ▼ information provided by the AEMC and the AER
- ▼ any publicly available information, and
- ▼ information provided by a retailer under section 234A(8) of the Act.<sup>72</sup>

From the AEMC and AER, the information we considered includes:

- ▼ the AEMC's 2016 Retail Competition Review Final Report and consumer and retailer survey results
- ▼ performance statistics (including customer numbers and contract types) from the AER's website,
- ▼ the AER's 2015-16 Annual Report on the Performance of the Retail Energy Market, and
- ▼ market offer information from the AER's EnergyMadeEasy website.<sup>73</sup>

The publicly available information we considered includes:

- ▼ AEMO data on customer transfers/switching
- ▼ EWON complaints data/annual report
- ▼ half-yearly reports for listed retailers – AGL, Origin Energy and CLP Group (EnergyAustralia)
- ▼ reports by various consumer and community groups, such as St Vincent de Paul Society, Choice, and Energy Consumers Australia, and
- ▼ various media articles published throughout the year.

From retailers, we requested and considered information on their prices for both residential and small business customers in each of the NSW electricity network supply areas they are active.<sup>74</sup> In particular, we considered each retailer's:

- ▼ electricity standing offers
- ▼ lowest priced generally available electricity market offer, and
- ▼ most common offer for electricity (by number of small customers).

<sup>72</sup> Section 234A(8) of the Act states that the Market Monitor may, by notice in writing served on a retailer, require the retailer to provide it with particulars of the number of market offer customers of the retailer, the market offer prices of those customers, the number of customers on each standing offer price offered by the retailer that has been publicly advertised and those standing offer prices.

<sup>73</sup> [www.energymadeeasy.gov.au](http://www.energymadeeasy.gov.au)

<sup>74</sup> We requested bi-annual price information from July 2015 to June 2016.

Finally, we considered submissions to on our Fact Sheet and Draft Report. These are available on our website.

### 3.3 Our process for this review

In May 2016, we began our review process by releasing a Fact Sheet, inviting comment on our proposed approach for undertaking our review. We received two submissions. The submission from AGL supported our proposed approach and the submission from the Minister asked that IPART consider whether price changes in July 2016 are consistent with a competitive market.

We released our Draft Report in September, and received six submissions. Both the submissions on our Fact Sheet and our Draft Report are available on our website.<sup>75</sup> We respond to comments in the submissions on our Draft Report in section 2.6.

The timetable and key milestones for our 2016 report on the performance and competitiveness of the NSW retail electricity market is summarised in Table 3.1.

**Table 3.1 Timetable and key milestones for the 2016 annual report**

<b>Milestone</b>	<b>Date</b>
<b>Released Fact Sheet</b>	<b>23 May 2016</b>
Submissions on Fact Sheet closed	20 June 2016
<b>Released Draft Report</b>	<b>22 September 2016</b>
Submissions on Draft Report closed	27 October 2016
<b>Provided Final Report to the Minister</b>	<b>By 30 November 2016</b>

<sup>75</sup> <https://www.ipart.nsw.gov.au/Home/Industries/Energy/Reviews/Electricity/Retail-electricity-market-monitoring-2016>



## 4 Barriers to entry, exit and expansion

The first competition indicator we considered for this review is the economic, legal, regulatory or other barriers that affect retailers' ability to enter the retail electricity market in NSW, expand their share of this market share, and exit the market.

In our view, the most important feature for a competitive market is low barriers to entry. This means new retailers are able to enter the market and compete for customers, and incumbent retailers face an ongoing threat of competition from new entrants. This ongoing threat provides the most effective protection for customers from the exercise of market power.

The section below summarises our finding on barriers to entry, expansion and exit. In the sections that follow we discuss our assessment in more detail, including how barriers are affecting new retailers entering the market and gain market share.

### 4.1 Overview of our finding

Our finding is that barriers to entry, expansion and exit in the NSW retail electricity market are not excessive. However, barriers could be reduced by removing inconsistencies between the various state-based green energy and energy efficiency schemes.

Six new entrants entered the NSW retail market in the 2015-16, in addition to five retailers that became active in 2014-15.<sup>76</sup> The trend for smaller retailers to gain market share from the 'big three' retailers has continued in 2015-16.<sup>77</sup> We expect that it would take some time for a smaller retailer to build a substantial market share.

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<sup>76</sup> Energymadeeasy.com.au; AER retail performance statistics as at March 2016; Byron Shire News, *Enova Energy begins roll out*, 10 June 2016, at <http://www.byronnews.com.au/news/enova-energy-begins-roll-out/3042619/> accessed 16 September 2016; and IPART, *Review of the performance and competitiveness of the retail electricity market in NSW – Final Report*, November 2015, pp 24-25.

<sup>77</sup> AER retail performance statistics as at March 2016.

## 4.2 Assessment of barriers to entry, expansion and exit

This section outlines our assessment of barriers to entry, expansion and exit. See Box 4.1 for details on the information we used to make our assessment.

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### Box 4.1 Information used to assess barriers to entry, expansion and exit

To make our assessment, we reviewed surveys of retailers that addressed their views on barriers to entry, expansion and exit in the NSW retail electricity market. Retailer research was conducted in early 2016 by Farrier Swier Consulting as part of the AEMC's 2016 retail competition review. We also used AER data on the number of retailers contesting the market and the market share of these retailers (by number of small customers).

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#### 4.2.1 Retailer views on barriers to entry, expansion and exit

In AEMC's 2016 retail competition review, retailers were asked if they found it easy to enter, expand and exit the retail market. They were also asked to identify any barriers to entering or expanding across multiple jurisdictions, and any impediments to retailing in rural or regional areas.

Retailers gave an average rating of between moderate and high in terms of ease of entry and expansion into the NSW retail market, consistent with last year's result.<sup>78</sup> The responses indicated that NSW and Victoria were considered to be markets with the lowest barriers to enter and expand in the National Electricity Market (NEM).<sup>79</sup>

Retailers did not comment on any barriers to exit in the survey. In April 2016, one retailer, Go Energy, exited the NSW market after it was suspended from the NEM by AEMO for failing to comply with its prudential requirements. All former customers of Go Energy were transferred to other standard retailers under the Retailer of Last Resort arrangement, their access to service continued uninterrupted during the transition.<sup>80</sup>

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<sup>78</sup> AEMC, *2016 Retail Competition Review Final Report*, June 2016, p 94.

<sup>79</sup> Ibid, pp 93-94.

<sup>80</sup> <https://www.aer.gov.au/news-release/former-go-energy-electricity-customers-transferred-to-new-retailers>, accessed 7 September 2016.

### Perceived barriers to entry and expansion in NSW

In NSW, the top three barriers to entry and expansion cited by retailers (as a percentage of electricity retailers surveyed) were:

- ▼ difficulty accessing reasonably priced hedging products (40%)
- ▼ compliance costs imposed by state-based and NEM-wide environmental and energy efficiency schemes (38%), and
- ▼ prudential and credit support arrangements (33%).<sup>81</sup>

Retailers commonly mentioned tightening wholesale market conditions and difficulties accessing reasonably priced hedging products as a barrier to entry. In NSW, retailers pointed to the increasing vertical integration and concentration in the wholesale market amongst the big three retailers.<sup>82</sup> Compliance costs associated with environmental and energy efficiency schemes and the provisions of credit support to AEMO and distributors were also identified as barriers to entry.

Other relevant findings from the retailer survey include:

- ▼ A majority of retailers did not consider there to be additional barriers to enter or expand in the regional market relative to urban markets in NSW.<sup>83</sup>
- ▼ Economies of scale and scope are seen as important factors to compete effectively in the NSW retail market.<sup>84</sup>
- ▼ Smaller retailers found it challenging to gain market share due to the aggressive retention campaigns adopted by incumbent retailers.<sup>85</sup>

#### 4.2.2 Our views on barriers to entry, expansion and exit in NSW

In our view there are no substantial barriers for smaller retailers to enter the NSW electricity market.

Limited access to competitively priced hedging products is an economic barrier that relates to the presence of large vertically integrated electricity businesses in the market. This presence could mean that a new retailer to the market needs considerable financial capacity to rapidly gain market share. The main implication of this and other economic barriers is that structural changes in the market are likely to take some time to occur. Smaller retailers are able to access exchange-traded derivative product to hedge their risk exposure.

<sup>81</sup> AEMC, *2016 Retail Competition Review Final Report*, June 2016, p 95.

<sup>82</sup> AEMC, *2016 Retail Competition Review Final Report*, June 2016, p 98.

<sup>83</sup> Ibid, p 100.

<sup>84</sup> Ibid, pp 101-102.

<sup>85</sup> Ibid, p 100.

Retailers are required to provide credit support to mitigate the risk that they default on money they owe. These prudential requirements are in place to ensure confidence in the operation of the market. Recently, the AEMC has made a draft Rule in relation to AEMO's rule change request regarding the application of offsets in the prudential margin calculation under the NER. The draft Rule would support competition in the NEM by potentially lowering the costs of providing credit support for market participants particularly for standalone retailers and generators.<sup>86</sup>

Currently there are inconsistencies between state-based energy efficiency schemes that present a barrier to entering the market. As many retailers operate under several Australian jurisdictions, such inconsistencies mean retailers require greater resources to manage compliance with the schemes. In our view, this is an unnecessary regulatory barrier the cost of which is paid for by customers. As energy efficiency is an eligible activity under the Australian Government's Emissions Reduction Fund, the continued operation of state-based schemes may duplicate rather than complement the objectives of this fund. If this is the case, duplicative components of state-based schemes could be wound up and any residual functions that are complementary could be transitioned to a national scheme. Clear transition arrangements would need to be put in place to maintain certainty for businesses investing in state-based energy efficiency schemes. In response to our draft report *Origin and EnergyAustralia* both supported this recommendation.<sup>87</sup> PIAC agrees that duplication between state and federal schemes increases costs for consumers, and supports our recommendation, subject to careful analysis of impacts on low-income households.<sup>88</sup>

#### Recommendation

- 1 That, to reduce the barriers for small retailers entering the NSW retail electricity market, the NSW Government wind down duplicative components of state-based green energy and energy efficiency schemes, with the option to transfer any residual functions that are complementary to a national scheme such as the Emissions Reduction Fund. (This would be a similar process to the winding down of the NSW Greenhouse Gas Reduction Scheme (GGAS) in June 2012). Clear transition arrangements would need to be put in place to maintain certainty for businesses investing in state-based energy efficiency schemes.

<sup>86</sup> AEMC, *Draft Rule Determination – Nation Electricity Amendment (Application of Offsets in the Prudential Margin Calculation)* Rule 2016: Rule Proponent AEMO, September 2016, pp i-ii.

<sup>87</sup> EnergyAustralia submission to Draft Report, 27 October 2016, p 3; and Origin submission to Draft Report, 27 October 2016, pp 3-4.

<sup>88</sup> PIAC, *A competitive market to benefit all – IPART Review of the performance and competitiveness of the retail electricity market in NSW*, 27 October 2016, p 24

### 4.3 Number of retailers contesting the market

The extent to which there are barriers to entering the market will affect how many retailers are competing for customers. In general, the greater the number of active retailers, the stronger is the level of competition in the market.

As at 30 June 2016, there were 26 retail brands owned by 22 electricity retailers supplying to small retail customers in NSW, with seven retailers also supplying gas (Figure 4.1). Six new retail brands entered the NSW retail market during 2015-16, in addition to five retail brands that entered in 2014-15. The number of second-tier retailers has doubled since the removal of price regulation in NSW from 1 July 2014.

**Figure 4.1** Energy retailers contesting in NSW as at 30 June 2016



**Note:** The six new market entrants in the 12 months to 30 June 2016 are: 1st Energy, Alinta Energy, Commander Energy, Enova Energy, Mojo Power, and Urth Energy. One retailer exited the NSW market: GoEnergy was suspended from the NEM by AEMO for failing to comply with its prudential requirements, and its authorisation to trade in the NEM was revoked on 2 April 2016.

**Data source:** Energymadeeasy.com.au; AER retail performance statistics as at March 2016; and Byron Shire News, *Enova Energy begins roll out*, 10 June 2016, accessed 13 September at <http://www.byronnews.com.au/news/enova-energy-begins-roll-out/3042619/>

#### 4.4 Market Concentration

As at March 2016, the big three retailers had around 92% market share in the NSW electricity market:

- ▼ AGL<sup>89</sup> (25%)
- ▼ EnergyAustralia (30%), and
- ▼ Origin Energy (36%).

The extent of concentration in a market can be measured using the Herfindahl-Hirschman Index (HHI),<sup>90</sup> and the ACCC consider an index greater than 2,000 to indicate a concentrated market.<sup>91</sup> Over the 12 months to March 2016, the HHI index for the NSW retail electricity market decreased by 4.5% from 3,015 to 2,916. Smaller retailers are steadily gaining market share from the big three retailers, but we expect that it would take some time for a small retailer to build a substantial market share.

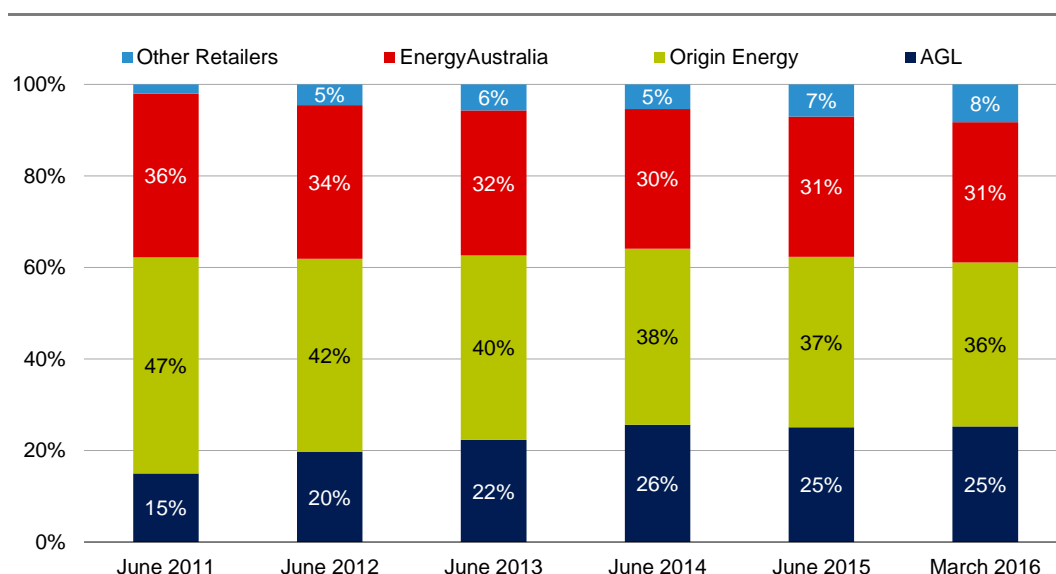
Figure 4.2 and Figure 4.3 show the changes in market share in both the residential and small business markets. For both there is a consistent trend of smaller retailers gaining market share at the expense of the big three retailers in NSW. In June 2011, smaller retailers supplied only 2% of the residential market, this has grown to about 8% in March 2016 quarter. Similarly in the small business market, smaller retailers grew their share from less than 1% to about 13% in the last five years (Figure 4.3).

<sup>89</sup> AGL also owns or operates other retailers, including Powerdirect, Australian Power & Gas and ActewAGL Retail (owned equally with Icon Water Limited). For the purpose of our market analysis, we have grouped all these customers under one AGL group.

<sup>90</sup> The HHI is a commonly accepted measure of market concentration. It is calculated by squaring the market share of each firm competing in a market, and then summing the resulting numbers. The HHI can range from close to zero to 10,000.

<sup>91</sup> In NSW, the residential market has a HHI of 2,931, and the small business market has a slightly lower HHI of 2,802.

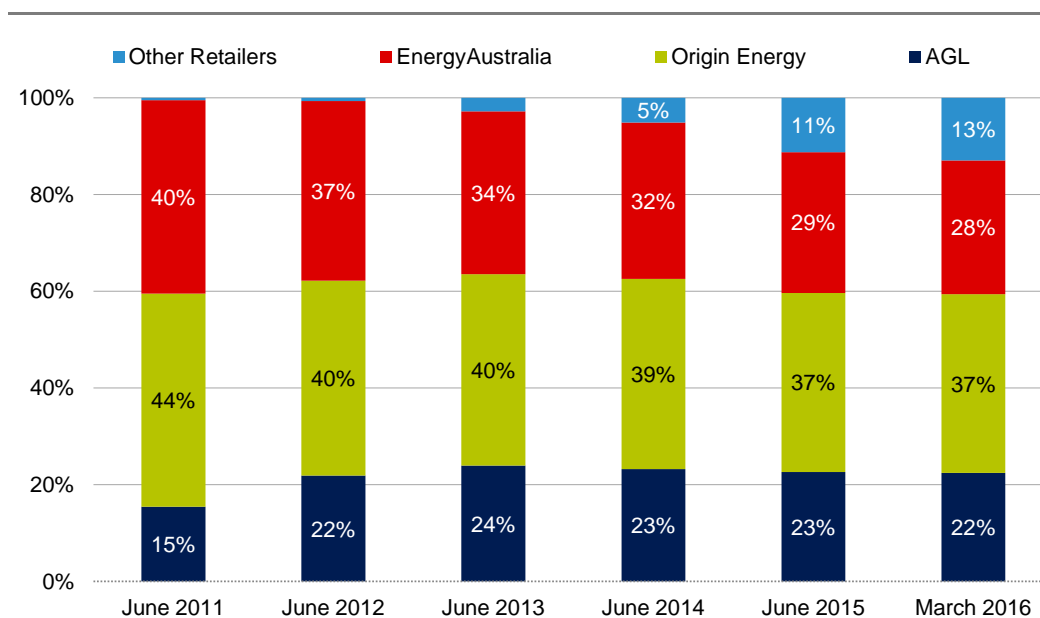
**Figure 4.2 Change in electricity retailers' market share – NSW residential customers**



**Note:** A small electricity customer is a customer consuming less than 100 MWh of electricity usage each year.

**Data source:** AER Retail performance statistics as at March 2016.

**Figure 4.3 Change in electricity retailers' market share – NSW small business customers**



**Data source:** AER Retail performance statistics as at March 2016.

## 5 Customer participation and outcomes

The next competition indicator we considered was customer participation and outcomes. Customer participation refers to customers being aware of the choices available to them in the market, and investigating the offers available to them to identify a better electricity plan or retailer for their circumstances.<sup>92</sup> Customer outcomes refer to how satisfied customers are with their participation in the market and with their retailer in general.

In a competitive market, we would expect most customers to be aware of the choices available to them, and many customers to be shopping around for a better deal. In markets where competition is working well, we would expect most customers to be satisfied with their participation and experience in the market.

In the sections below we summarise our findings and provide further information on our assessment.

### 5.1 Overview of our finding

Our finding is that most small customers in NSW are aware of the choices available in the market and many have decided to switch retailer or plan. Most customers report that they were satisfied with their involvement in the market. Key indicators of customer participation and outcomes are summarised in Figure 5.1 and Figure 5.2.

### 5.2 Assessment of customer participation and outcomes

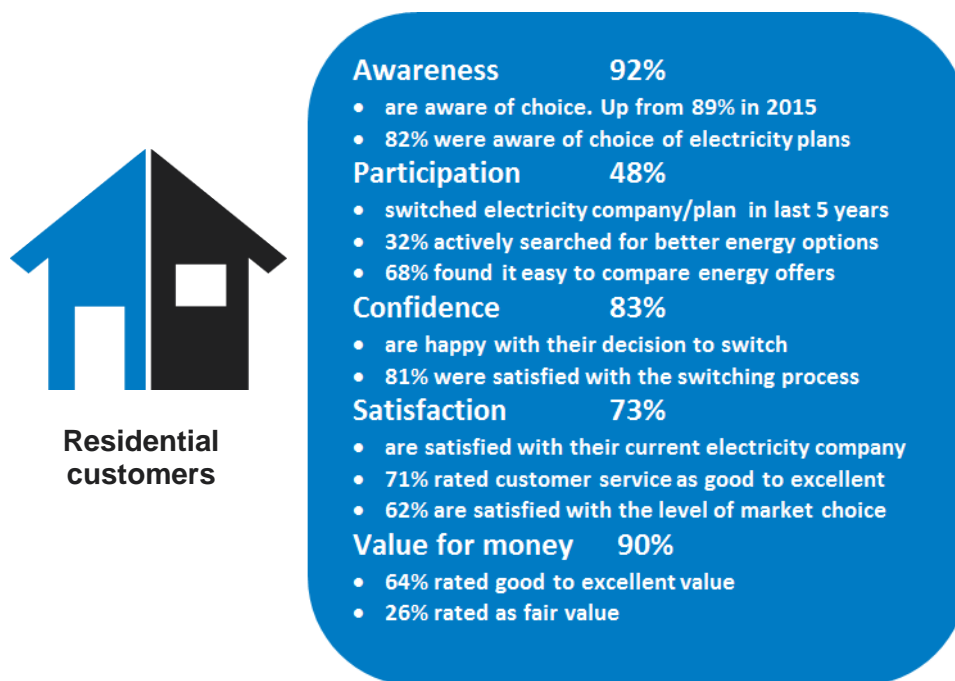
The key information we considered to assess customer participation and outcomes was the AEMC's customer surveys for its 2016 competition review. The AEMC commissioned Newgate Research to conduct these nationwide surveys.

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<sup>92</sup> Participating in the market does not necessarily mean customers switching retailers and offers, as they may shop around and decide their existing offer is the best one for them.

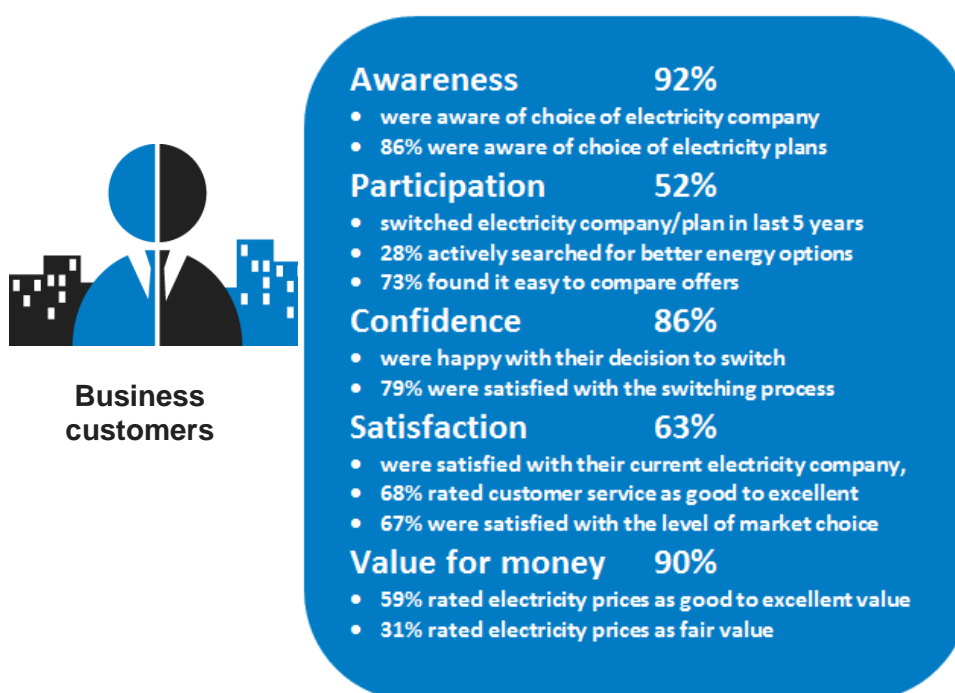


**Figure 5.1** Summary of residential customers' market awareness, participation and outcomes in 2015-16



**Data source:** Newgate Research, *Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets*, June 2016, pp 95-97.

**Figure 5.2** Summary of small business customers' market awareness, participation and outcomes in 2015-16



**Data source:** Newgate Research, *Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets*, June 2016, p 95.

## 5.3 Customer participation

### 5.3.1 Customer awareness and confidence

The level of awareness amongst small customers in NSW remains strong:

- ▼ 92% of residential and small business customers were aware they could choose their electricity retailer; and
- ▼ 82% of residential customers and 86% of small business customers were aware they could choose from different energy plans with varying pricing structures, contract lengths and terms.<sup>93</sup>

### 5.3.2 Customers are investigating and switching electricity retailers and/or offers

In the 12 months to June 2016, one in three (32%) residential customers in NSW actively searched for a better offer, and a slightly lower proportion (28%) of small business also investigated a better offer. On average, these customers spent less than two hours in their search.<sup>94</sup> Around half the customers surveyed in NSW indicated they have switched retailers and/or plans in the last five years. The percentage of customers that have switched electricity retailers or plans has declined marginally in the last 12 months to June 2016.<sup>95</sup> Increasing customer satisfaction with their current provider may be reason for the slightly lower switching rates. More than half (58%) the customers in NSW reported they were happy with their current arrangements or retailer, up from 39% in 2015.<sup>96</sup>

#### Why do customers switch?

As in previous years, price-related factors were ranked as the top two motivations to switch retailer or plan. There has been a marked increase in the number of retail customers switching because they were offered a better price or discounts, indicating that rivalry and acquisitive activities were robust.<sup>97</sup> For residential customers, the next most common reason for switching was moving house.

For small business customers, dissatisfaction with the service provided by their current provider was also a motivating factor.<sup>98</sup>

<sup>93</sup> Newgate Research, *Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets*, June 2016, p 97.

<sup>94</sup> Ibid, pp 98-100.

<sup>95</sup> Breakdown of retail customers that have switched are: residential (48%) and small business (52%) in 2016, compared with 52% and 54% respectively in 2015. Newgate Research, *Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets*, June 2016, p 110.

<sup>96</sup> Newgate Research, *Consumer Research for 2016 Nationwide Review of Competition in Retail Energy Markets*, June 2016, p 102.

<sup>97</sup> Ibid, p 112.

<sup>98</sup> Ibid, pp 112-113.

The AEMC customer survey found that to seriously consider switching retailer or plan, residential customers wanted to save an average of \$202 per year on their electricity bill and small business customers wanted to save about \$477 on their electricity bill. Those with higher energy bills wanted to see a bigger saving before they considered switching.<sup>99</sup>

### Why do customers investigate, but not switch?

Specifically, of those customers that investigated but chose to remain with their current electricity retailer or plan, reasons given were:

- ▼ 38% stated they were happy with their current retailer or plan, they wanted to compare prices but had no real need to change
- ▼ 19% found their current plan was better anyway or current retailer offered a better deal upon request
- ▼ 14% remained because they had signed a contract or was on a solar plan
- ▼ 11% felt it was not worth the effort/too much hassle or would make no difference in price paid, and
- ▼ around 10% thought there was a lack of information on best available deal, lack of trust in energy companies or found the switching process too confusing.<sup>100</sup>

### Why do customers not investigate their options at all?

Around two in three customers in NSW did not investigate switching energy options. They cited very similar reasons for their inactivity compared with last year's survey, overall:

- ▼ 33% of residential and 28% of business customers stated they were happy with their current retailer or current arrangement – they saw no reason to change
- ▼ 25% of residential and 45% of business customers felt it was too much hassle or did not have the time to research and switch
- ▼ 22% of residential and 17% of business customers did not state a reason, and
- ▼ around 10% of all customers in NSW thought all the offers were very similar and would make no difference to price; or found the switching process too confusing.<sup>101</sup>

Figure 5.3 below shows that prior to price deregulation, the percentage of retail customers in NSW on standard contract stood around 40% in March 2014, which fell to around 27% by March 2016. This indicates that a greater number of retail

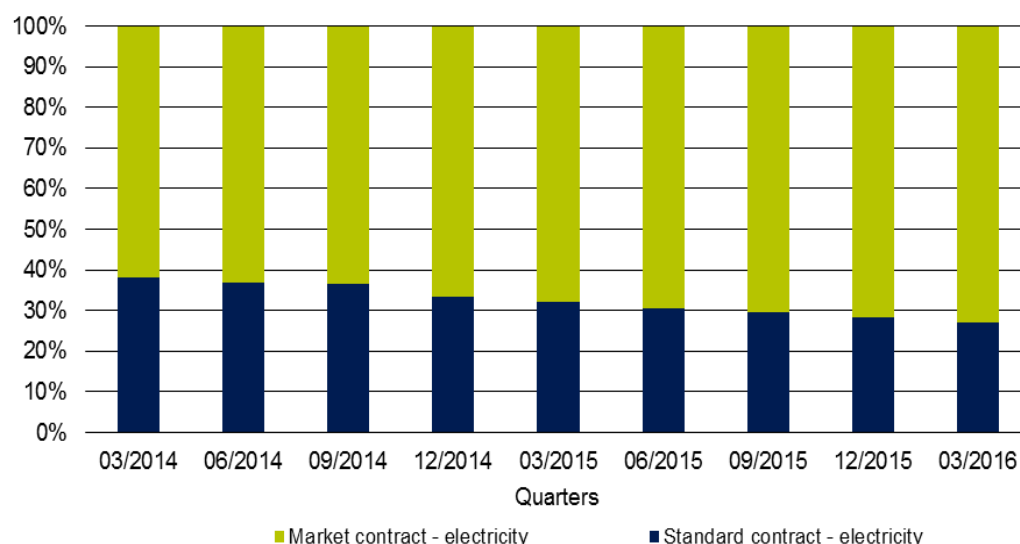
<sup>99</sup> Ibid, p 116.

<sup>100</sup> Ibid, p 102.

<sup>101</sup> Ibid, p 99.

customers have opted to switch to a market contract since the removal of price regulation in NSW.

**Figure 5.3 Proportion of standing and market contracts in NSW 2015-16**



**Data source:** AER, NSW – Small retail customer contract types, <https://www.aer.gov.au/retail-markets/retail-statistics/nsw-small-customer-contract-types>, accessed August 2016.

### 5.3.3 Search costs and price comparator sites

More than a third of residential customers and almost half of small businesses customers stated that the time, search cost and complexity of switching has discouraged them from looking for a better energy deal.

Over 68% of residential customers found it very to fairly easy to compare electricity offers, but they still thought the process is more complex than comparing and selecting other services, such as home/car/health insurances, internet and telecommunication plans, or banking services.<sup>102</sup>

Notwithstanding the NSW Government's 'the power's in your hands' campaign, awareness of government comparator websites is lower than the previous year (down by 5%). For instance, only one in 10 customers surveyed could recall EnergyMadeEasy. By comparison, NSW customers are twice as likely to recall other commercial/sponsored online price comparator sites such as iSelect, GoSwitch, Compare the Market, youcompare and Energy Watch.<sup>103</sup>

We consider that as competition in the retail market continues to strengthen, customers' searching and switching would be expected to continue to reduce as retailers will strive to make their offers as visible and easy to access as possible. In addition to the [energymadeeasy.gov.au](http://energymadeeasy.gov.au) website, retailers can also achieve this

<sup>102</sup> Ibid, p 103.

<sup>103</sup> Ibid, pp 108-109.

through commercial comparator websites. In its report for GetUp!, CME notes that commercial switching sites only include offers from a subset of retailers.<sup>104</sup> Nevertheless, we consider these sites can encourage customers to engage in the energy market, and can also offer substantial savings to customers that might not otherwise have switched retailer. As more customers use these commercial switching sites, competition between retailers on these platforms would also intensify, and we would expect the range and value of offers available to improve over time.

## 5.4 Customer outcomes

### 5.4.1 Satisfaction with switching electricity retailer or plan

A majority of customers who chose to switch retail supplier or plan were happy with their decision:

- ▼ 83% of residential customers and 86% of small business customers who switched electricity retailer or plan were happy with the decision to switch, up by five percentage points for both customer groups compared to last year's survey.<sup>105</sup>
- ▼ 81% of residential customers and 79% of small business customers were satisfied with the switching process.<sup>106</sup>
- ▼ Around 60% of satisfied customers cited cost savings and cheaper prices as the predominant reason they were happy with their switching decision; and to a lesser degree, they were also happy with the discounts offered.
- ▼ Smooth/easy switching process and improved customer service were also important reasons for customers' satisfaction from switching. Small business customers in particular cited these factors as being more important than for example discounts in impacting their level of satisfaction with their decision to switch.<sup>107</sup>

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<sup>104</sup> CME, *Australia's retail electricity markets: who is serving whom? – A report prepared for GetUp!*, August 2016, p 10.

<sup>105</sup> Ibid, p 122.

<sup>106</sup> Ibid, p 122.

<sup>107</sup> Ibid, pp 123-124.

### 5.4.2 Satisfaction with electricity retailer

The AEMC's customer survey indicates that NSW residential customers' satisfaction levels remained stable compared with previous years, while satisfaction amongst small business customers improved significantly from the previous survey. Customers' perceived satisfaction with their current retailer, in terms of quality of customer service and value for money are as follows:

- ▼ 73% of residential customers and 63% of small business customers responded that they were very or somewhat satisfied with their current electricity retailer, compared with 74% and 61% respectively in 2015.<sup>108</sup>
- ▼ 71% of residential consumers and 68% of small business customers rated the overall quality of customer service provided by their electricity retailer as good to excellent. A significantly greater proportion of small businesses gave their retailer a higher rating this year, up from 45% to 68%.<sup>109</sup>
- ▼ Two thirds of retail customers surveyed rated value for money provided by their electricity retailer as good to excellent. Around a quarter thought they were getting fair value from their retailer. Again, approval ratings from small businesses rose significantly, 59% reported obtaining good to excellent value from their retailer, up from 32% in the previous survey.<sup>110</sup>

Energy Consumers Australia (ECA) conducts bi-annual nation-wide surveys asking households to rate their levels of satisfaction based on four main criteria, including: value for money, customer service, reliability and billing and account options. ECA found that NSW households are most satisfied with the reliability of electricity services (72%), followed by billing and account options (62%) and customer service (55%). ECA also found that around half of the NSW households are satisfied with the value for money of electricity services, which is higher than in any other state.<sup>111</sup>

In those states where prices are deregulated, ECA reported consumers were much more likely to be satisfied with the level of competition in energy markets. NSW had one of the higher ratings nationally, with around half of survey responders rating their satisfaction level 7 or more out of 10 in terms of their view that the market could provide greater value for money in the long term.<sup>112</sup>

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<sup>108</sup> Ibid, p 119.

<sup>109</sup> Ibid, p 120.

<sup>110</sup> Ibid, p 121.

<sup>111</sup> Satisfaction is measured based on percentage of Australian households giving positive ratings of 7 out of 10 or higher. Source: ECA, *Energy Consumer Sentiment Survey Findings*, July 2016, pp 2-3.

<sup>112</sup> Ibid.

### 5.4.3 Complaints about electricity retailers

The AER reported that complaints to retailers increased during 2015-16, but that a large proportion of the increase was due to Origin's introduction of new complaint processes, which led to it recording higher complaint numbers over the first three quarters of 2015-16. The AER noted that excluding the increases to Origin, complaint rates were flatter across most jurisdictions, with other tier 1 retailers AGL and EnergyAustralia reporting significant decreases.<sup>113</sup>

In contrast, the Energy & Water Ombudsman NSW (EWON)<sup>114</sup> reported that the overall number of complaints about electricity retailers decreased by 27% compared to 2014-15, and by 45% since 2013-14.<sup>115</sup> The AER noted that the significantly lower number of complaints to EWON supports a view of improved complaint management by retailers. Retailers with effective customer service are generally able to promptly resolve customer complaints when they receive them, without the complaints needing to be escalated or referred elsewhere to be resolved.<sup>116</sup>

### 5.4.4 Outcomes for vulnerable customers

AEMC's consumer research in 2016 sought to collect better information on vulnerable energy customers. These customers were identified as those who are experiencing social and/or financial difficulties that mean that they are especially impacted by energy price increases, worried about the effects of changing their arrangements or susceptible to stressful experiences because they cannot always pay on time.<sup>117</sup>

The research found that consumers sit on a spectrum from low to high risk of vulnerability and a customer's degree of vulnerability varies over time depending on their financial, social and personal circumstances. Some vulnerable customer segments are not aware of support services available. The AEMC identifies approximately 20% of households as most vulnerable, which are made up largely of low income groups (12%) and middle income families (8%). The research found that low income households tend to have access to government services and consequently has access to a range of available support. On the other hand, middle income families may be overwhelmed by debt, not in

<sup>113</sup> AER, *Annual Report on the Performance of the Retail Energy Market – 2015-16*, November 2016, pp 23-24.

<sup>114</sup> EWON provides a free and independent dispute resolution service for all retail customers that has lodged a complaint against an energy retailer in NSW.

<sup>115</sup> EWON's annual reports reported 15,659 complaints about electricity retailers in 2015-16; 21,415 complaints in 2014-15; and 28,600 complaints in 2013-14. Sources: EWON, *Annual Report 2015/2016*, October 2016, p 21; EWON, *Annual Report 2014-2015*, December 2015, p 22.

<sup>116</sup> AER, *Annual Report on the Performance of the Retail Energy Market – 2015-16*, November 2016, pp 8, 23-24.

<sup>117</sup> AEMC, *Energy consumer research 2016 – Information*, 30 June 2016, p 1.



touch with general government support and unaware of help they may be entitled to.<sup>118</sup>

While vulnerable customer experiences and outcomes were found to be broadly consistent with that of all customers, negative outcomes can have greater consequences for vulnerable customers. The AEMC notes that vulnerable customers that do not investigate their options and miss out on savings available in the competitive market might be forgoing savings they could otherwise put toward other important needs.<sup>119</sup>

In trying to identify why vulnerable customers do not shop around, the research found that vulnerable customers:<sup>120</sup>

- ▼ do not clearly understand the links between energy use and costs,
- ▼ are not aware of the plan they are on or that they can choose from various plans from their own or different retailers,
- ▼ have limited understanding of terminology used on bills, such as KWh, or the difference between standing and market offers, and
- ▼ will tend to stick with their existing retailer because they have a risk adverse nature, which is partly due to a lack of financial capacity, fear of making the wrong decision and concern about how their circumstances may be perceived by a retailer.

Like all customers surveyed for AEMC's research, nearly all vulnerable customers were unaware of the government-run energy comparison website [energymadeeasy.gov.au](http://energymadeeasy.gov.au). When given an opportunity to try the website, most thought it was easy to understand and to use, and considered it a useful tool to assess options available to them.<sup>121</sup> As noted by the AER, while concessions represent an important saving for eligible households, for many households there are significant savings to be achieved just by switching to a cheaper offer.<sup>122</sup>

### Customers on payment plans or hardship programs

In its annual report on the performance of the retail energy market in 2015-16, the AER observed a decrease in the proportion of residential customers in NSW repaying electricity debt, and a decrease in the average debt of customers entering into payment plans and hardship programs.<sup>123</sup> However, while the share of customers on payment plans decreased, the number of customers on

<sup>118</sup> AEMC, *Energy consumer research 2016 – Information*, 30 June 2016, p 1.

<sup>119</sup> AEMC, *Energy consumer research 2016 – Information*, 30 June 2016, p 1; and AEMC, *2016 Retail Competition Review – Final Report*, 30 June 2016, p 46.

<sup>120</sup> AEMC, *2016 Retail Competition Review – Final Report*, 30 June 2016, p 46.

<sup>121</sup> AEMC, *2016 Retail Competition Review – Final Report*, 30 June 2016, pp 46, 52.

<sup>122</sup> AER, *Annual Report on the Performance of the Retail Energy Market – 2015-16*, November 2016, p 52.

<sup>123</sup> AER, *Annual Report on the Performance of the Retail Energy Market – 2015-16*, November 2016, p 27.



hardship programs increased. The AER notes that the increase in the proportion of customers on hardship programs and the lower debt level of customers entering hardship programs suggests retailers are now willing to offer this high level of assistance before debt levels get too high and also that customers are actively seeking assistance from their retailers when they need it.<sup>124</sup> The AER also found that of the electricity customers that exited hardship programs, the proportion that did so due to successfully paying off debt increased nationally from 24% in 2014-15 to 36% in 2015-16.<sup>125</sup> However, the report also notes that the overall success rate for hardship programs remain relatively low, with only six retailers reporting a success rate for more than 10% of their hardship customers.<sup>126</sup>

### Disconnections and reconnections

The AER reported that in NSW, residential electricity disconnections for non-payment decreased in 2015-16 to the lowest level in three years.<sup>127</sup> However, the AER found that nationally, there was an increase in the proportion of disconnected electricity customers that had been on a payment plan in the previous 12 months, or that had been disconnected more than once in the previous 24 months. The AER suggests this may be a sign that more customers are experiencing long-term and/or severe financial difficulties. It notes that in many cases, disconnection occurs because customers are unwilling to engage with retailers about their financial difficulties, which can be due to a range of factors, including shame and distrust.<sup>128</sup>

However, the AER also emphasises that the low disconnection rates for hardship customers clearly highlight the benefit of customers proactively discussing their payment difficulties with their retailer and negotiating a sustainable approach to repaying debt.<sup>129</sup>

In November 2016, a Sustainable Payment Plans Framework developed by the AER was commenced. This framework sets out good practice principles for retailers intended to improve the quality of 'capacity to pay' conversations with customers by encouraging open, clear and ongoing engagement based on trust, respect and empathy. The framework allows flexibility while encouraging retailers to offer extra assistance to customers, and its aim is to achieve better

<sup>124</sup> AER, *Annual Report on the Performance of the Retail Energy Market – 2015-16*, November 2016, pp 9, 37.

<sup>125</sup> AER, *Annual Report on the Performance of the Retail Energy Market – 2015-16*, November 2016, p 39.

<sup>126</sup> AER, *Annual Report on the Performance of the Retail Energy Market – 2015-16*, November 2016, p 41.

<sup>127</sup> AER, *Annual Report on the Performance of the Retail Energy Market – 2015-16*, November 2016, p 43.

<sup>128</sup> AER, *Annual Report on the Performance of the Retail Energy Market – 2015-16*, November 2016, pp 46-47.

<sup>129</sup> AER, *Annual Report on the Performance of the Retail Energy Market – 2015-16*, November 2016, p 47.

outcomes by helping customers and retailers agree to payments plans that are affordable and sustainable. Implementing the framework is voluntary, and a list of the retailers that have committed to the framework's standards is available at <https://www.aer.gov.au/consumers/my-energy-bill/experiencing-trouble-paying-your-energy-bills>.<sup>130</sup>

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<sup>130</sup> AER, *Annual Report on the Performance of the Retail Energy Market – 2015-16*, November 2016, pp 32-33, 47.

## 6 Price movements in 2015-16

The third competition indicator we examined was price movements. Measuring price movements is challenging given the dynamic nature of the retail electricity market. For example, retailers continually bring new offers to market and withdraw old offers, and all offers incorporate various non-price elements, such as the collection of frequent flyer points or inclusion of carbon offsets. While this chapter focuses on price movements, these price movements should not be considered on their own, but rather in conjunction with changes to product and price diversity, which we discuss in detail in Chapter 8.

For the purpose of assessing whether price movements in 2015-16 were consistent with a competitive market, we compared changes in prices over time, across distribution networks (including regional areas) and between retailers. In a competitive market, we would expect that in the long term, retail prices would change broadly in line with changes in underlying costs. In the short term, price movements may be greater than or less than observable changes in these costs, but we would likely see some general relationship between prices and costs.

### 6.1 Overview of our finding

Our finding is that price changes in 2015-16 reflect changes in the cost of supplying electricity and are therefore consistent with a competitive market.

Between June 2015 and June 2016, prices generally fell for both residential and small business customers. For residential customers price reductions ranged from around 3% to 18% depending on the network area. These were largely driven by reductions in network prices. Wholesale electricity costs were relatively stable while green costs likely placed some upward pressure on prices.

Substantial savings were also available to customers who moved from standing offer prices, and it is clear that many customers do shop around for better deals. As of June 2016, typical residential bills on the retailers' most common prices were on average \$260 to \$310 per annum cheaper than bills on standing offer prices, depending on the network area.

## 6.2 Assessment of price changes in 2015-16

Our approach for assessing whether price movements are consistent with a competitive market involved three steps:

1. comparing prices in June 2016 to prices in June 2015 for each network area
2. analysing changes in the main underlying costs of supplying electricity over the same period, and
3. assessing whether price changes related to cost changes.

We requested information on retailers' prices for residential and small business customers in each network area in NSW. We used these prices to estimate indicative bills for residential and small business customers. This means our approach provides a snapshot of prices and typical bills implied by these prices as at June 2015 and June 2016. We consider that this information provides an indication of how prices for most customers changed during this reporting period.

Box 6.1 provides more detail on this information and the assumptions we used in assessing price movements.

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### **Box 6.1 Information and assumptions we used in assessing price movements**

To measure price changes we requested information from electricity retailers operating in NSW, including their:

- ▼ standing offer prices (these are the default prices for customers who haven't taken up a market offer)
- ▼ most common prices by number of customers (noting that the most common prices are often based on offers no longer available in the month of reporting), and
- ▼ lowest generally available market offer prices.

Eighteen retailers responded to our information request, covering more than 98% of the small customer market. Retailers provided prices for residential and small business customers and for each network area in NSW as at June 2015, June 2016, and September 2016.

This information provides an overview of the range of prices that most customers were paying at different points in the reporting period. This information also indicates the savings available to customers who participate in the market relative to the retailers' standing offer prices or most common prices.

In analysing the prices, we estimated annual bills based on:

- ▼ assumed annual consumption of 6,500 kWh per year for residential customers and 10,000 kWh per year for small business customers, and
  - ▼ including all conditional and non-conditional discounts such as pay on time discounts and direct debit discounts.
-

## 6.3 Measuring price changes

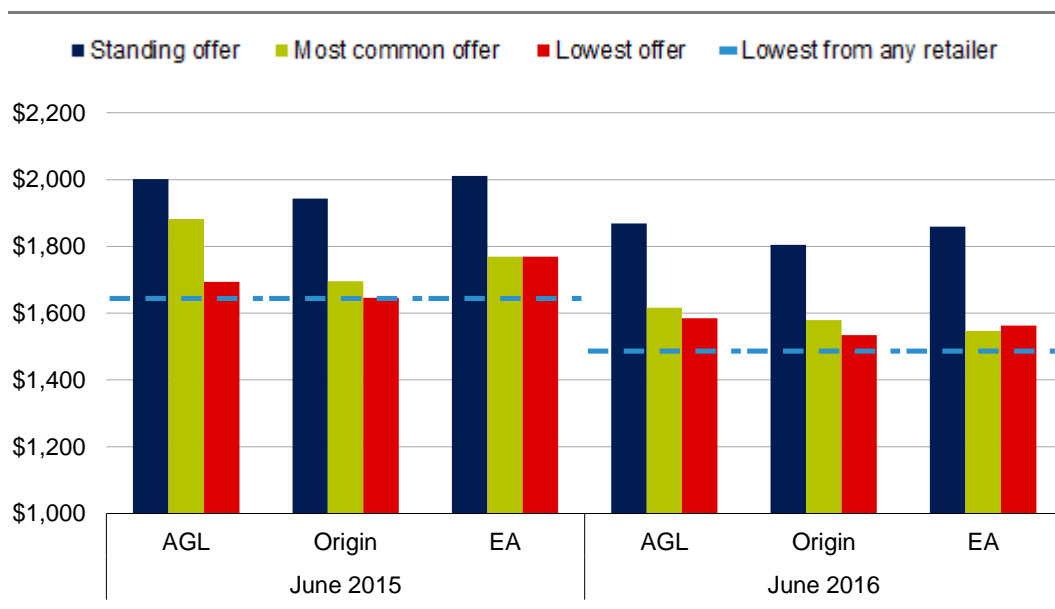
### 6.3.1 Changes in prices for residential customers

Figures 6.1 to 6.3 compare estimated annual bills for a typical residential customer based on the major retailers' prices in June 2015 and June 2016, across each network area. We focus on the three main retailers as this represents the majority of small customers in the market. Appendix A provides a complete list of estimated annual bills as at June 2016 for all of the retailers that submitted their pricing data to us.

#### Residential prices in June 2016 were substantially lower than prices in June 2015

Figures 6.1 to 6.3 clearly show that the standing offer prices, most common prices and lowest offer prices were substantially lower in June 2016 than in June 2015 for each of the three major retailers. Table 6.1 presents the ranges of estimated bill decreases under the standing offers and lowest priced offers in each network area. As explained in section 6.3, a large proportion of these decreases would be due to lower network tariffs in 2015-16.

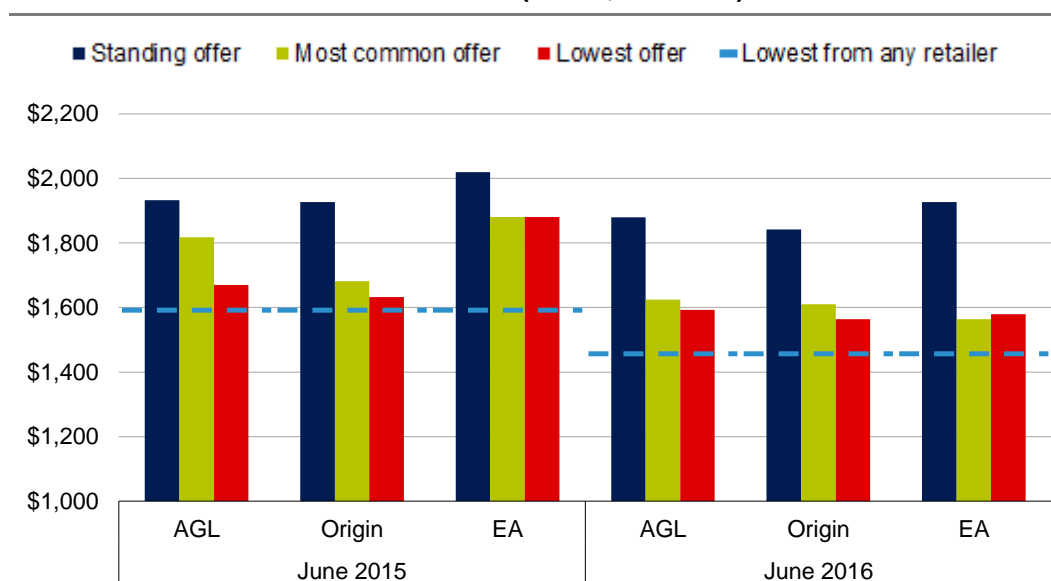
**Figure 6.1 Typical annual residential bills in the Ausgrid network area, June 2015 vs June 2016 (\$2016, inc. GST)**



**Note:** Bills are calculated based on annual consumption of 6,500 kWh, taking into account all available conditional and non-conditional discounts. The lowest available offers in June 2015 and June 2016 were from Dodo and QEnergy respectively.

**Data source:** Electricity retailers and IPART calculations.

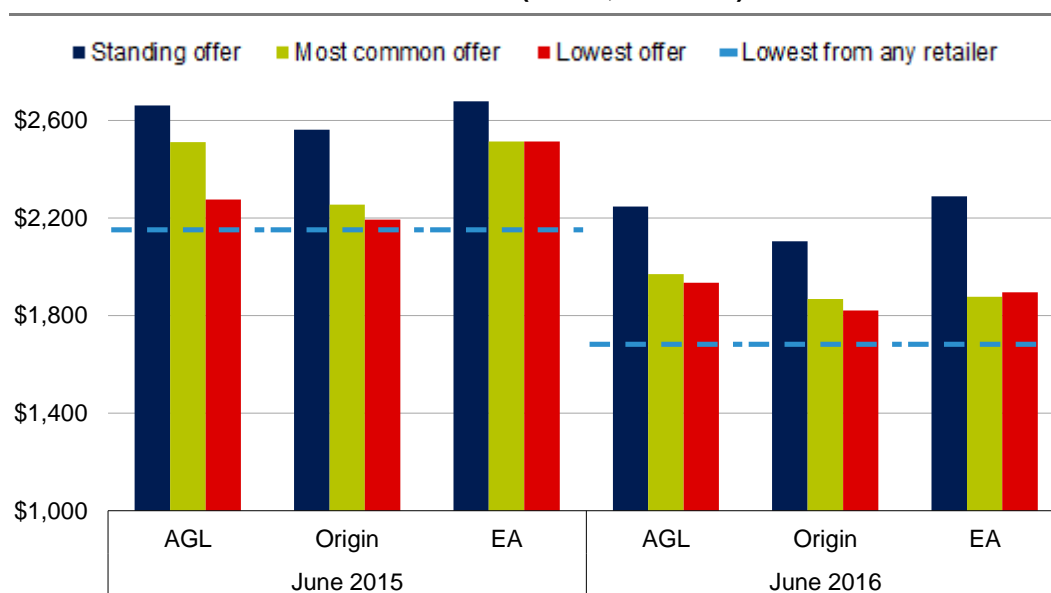
**Figure 6.2** Typical annual residential bills in the Endeavour network area, June 2015 vs June 2016 (\$2016, inc. GST)



**Note:** Bills are calculated based on annual consumption of 6,500 kWh, taking into account all available conditional and non-conditional discounts. The lowest available offers in June 2015 and June 2016 were from RED Energy and Simply Energy respectively.

**Data source:** Electricity retailers and IPART calculations.

**Figure 6.3** Typical annual residential bills in the Essential network area, June 2015 vs June 2016 (\$2016, inc. GST)



**Note:** Bills are calculated based on annual consumption of 6,500 kWh, taking into account all available conditional and non-conditional discounts. The lowest available offer in June 2015 was from both Lumo and RED Energy. The lowest offer in June 2016 was from Simply Energy.

**Data source:** Electricity retailers and IPART calculations.

**Table 6.1 Percentage changes in estimated residential bills between June 2015 and June 2016**

		Ausgrid network	Endeavour network	Essential network
Three major retailers	% change in standing offer bills	-7% to -8%	-3% to -5%	-15% to -18%
	% change in lowest offer bills	-6% to -12%	-4% to -16%	-15% to -25%
All retailers	% change in standing offer bills	-1% to -10%	-1% to -8%	-1% to -21%
	% change in lowest offer bills	-2% to -16%	-1% to -16%	-15% to -25%

**Note:** Bills are calculated based on annual consumption of 6,500 kWh, taking into account all available conditional and non-conditional discounts. The ranges represent our estimated changes in bills for each retailer's standing offer prices and lowest offer prices.

**Source:** Electricity retailers and IPART calculations.

### Residential customers can make substantial savings by shopping around

Figures 6.1 to 6.3 also show that customers can make substantial savings by shopping around. This is especially true for customers on standing offer prices, but also for other customers. Table 6.2 shows estimated annual bill savings available in June 2016 if a customer switched from one of the big three's standing offer prices or most common prices to the lowest priced offer by the same retailer or by any of the retailers.

**Table 6.2 Potential annual bill savings for residential customers switching from three major retailers' standing offer prices or most common prices in June 2016 (\$2016)**

	Ausgrid network	Endeavour network	Essential network
<i>Annual savings if switched from <b>standing offer prices</b> to lowest priced offer...</i>			
<i>...by same retailer</i>	\$270 to \$297	\$278 to \$347	\$284 to \$394
<i>...by any retailer</i>	\$318 to \$382	\$385 to \$470	\$423 to \$607
<i>Annual savings if switched from <b>most common prices</b> offer to lowest priced offer...</i>			
<i>...by same retailer</i>	\$32 to \$45	\$32 to \$46	\$35 to \$47
<i>...by any retailer</i>	\$61 to \$130	\$108 to \$168	\$186 to \$288

**Note:** Bills are calculated based on annual consumption of 6,500 kWh, taking into account all available conditional and non-conditional discounts.

**Source:** Electricity retailers and IPART calculations.

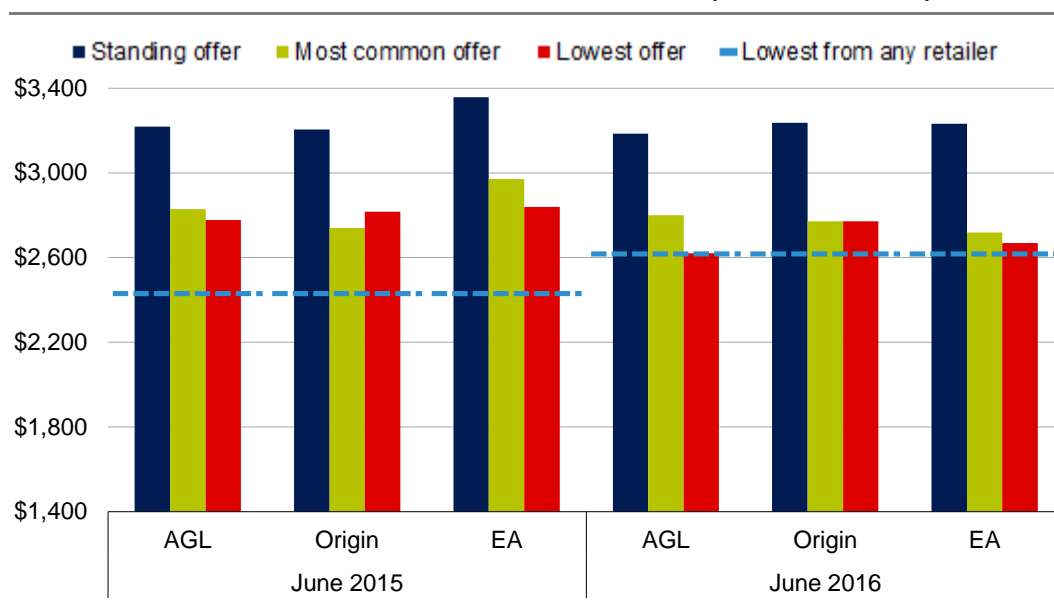
### 6.3.2 Changes in prices for small business customers

As for residential customers, we compared the changes in bills from June 2015 to June 2016 for a typical small business customer across each network area. Figures 6.4 to 6.6 show these changes for the standing offer prices, most common prices and lowest priced offers for the three major retailers. Appendix A compares estimated annual bills as at June 2016 for all the retailers that we received price data from.

#### Prices for small business customers were mostly lower in June 2016 than in June 2015

There was a tendency for prices for small business customers to be lower in June 2016 than in June 2015. However, the decreases were relatively smaller compared with the decreases observed in the residential market, and some retailers' offers were higher in June 2016 than in June 2015 (see Appendix A). Table 6.3 presents the ranges of the changes in estimated bills in each network area.

**Figure 6.4 Typical annual bills for small business customers in the Ausgrid network area, June 2015 vs June 2016 (\$2016, inc. GST)**

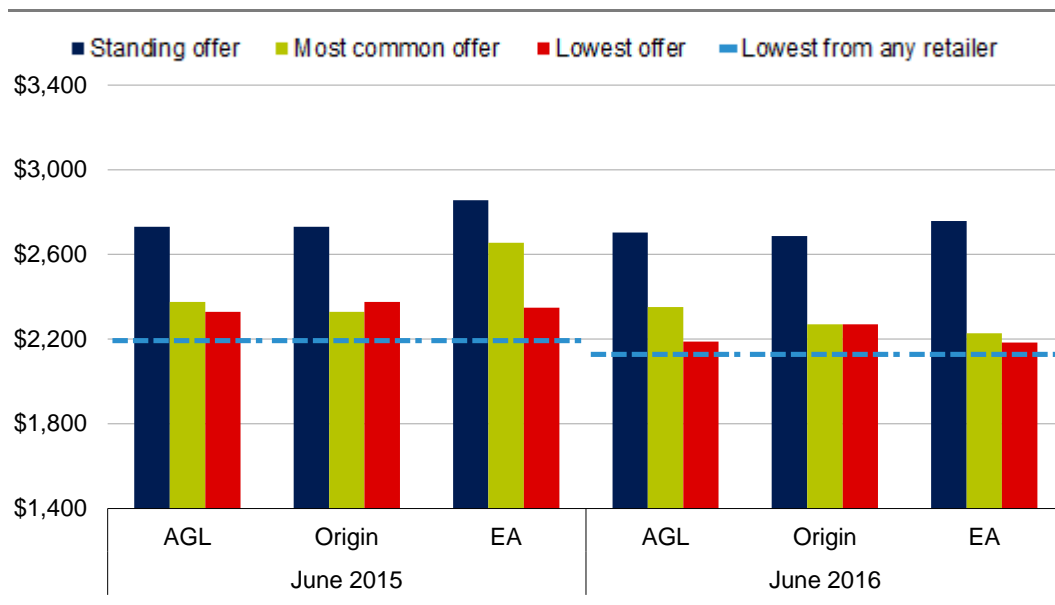


**Note:** Bills are calculated based on annual consumption of 10,000 kWh, taking into account all available conditional and non-conditional discounts. The lowest available offers in June 2015 and June 2016 were from Simply Energy and 1st Energy respectively.

**Data source:** Electricity retailers and IPART calculations.



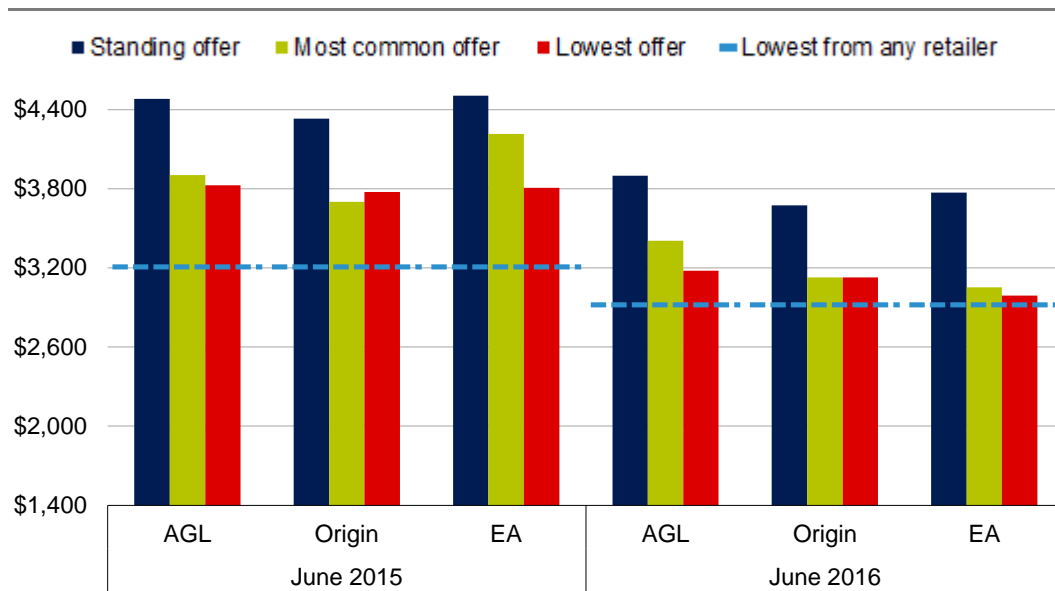
**Figure 6.5 Typical annual bills for small business customers in the Endeavour network area, June 2015 vs June 2016 (\$2016, inc. GST)**



**Note:** Bills are calculated based on annual consumption of 10,000 kWh, taking into account all available conditional and non-conditional discounts. The lowest available offers in June 2015 and June 2016 were from Next Business Energy and Q Energy respectively.

**Data source:** Electricity retailers and IPART calculations.

**Figure 6.6 Typical annual bills for small business customers in the Essential network area, June 2015 vs June 2016 (\$2016, inc. GST)**



**Note:** Bills are calculated based on annual consumption of 10,000 kWh, taking into account all available conditional and non-conditional discounts. The lowest available offers in June 2015 and June 2016 were from Lumo and Powershop respectively.

**Data source:** Electricity retailers and IPART calculations.

**Table 6.3 Percentage changes in estimated bills between June 2015 and June 2016**

		Ausgrid network	Endeavour network	Essential network
Three major retailers	% change in standing offer bills	-4% to +1%	-3% to -1%	-13% to -16%
	% change in lowest offer bills	-6% to -2%	-7% to -4%	-21% to -17%
All retailers	% change in standing offer bills	-18% to +4%	-8% to +7%	-19% to +9%
	% change in lowest offer bills	-18% to +10%	-7% to +19%	-22% to -1%

**Note:** Bills are calculated based on annual consumption of 10,000 kWh, taking into account all available conditional and non-conditional discounts. The ranges represent our estimated changes in bills for each retailer's standing offer prices and lowest offer prices.

**Source:** Electricity retailers and IPART calculations.

### Small business customers can make substantial savings by shopping around

Small business customers, like residential customers, can make considerable savings if they shop around, particularly those customers on standing offer prices. Table 6.4 shows estimated annual bill savings if a customer switched from standing offer prices or most common prices by the three major retailers to the lowest priced offer by either the same retailer or the any of the other retailers in June 2016.

**Table 6.4 Potential annual bill savings for small business customers switching from three major retailers' standing offer prices or most common prices in June 2016 (\$2016)**

	Ausgrid network	Endeavour network	Essential network
<i>Annual savings if switched from <b>standing offer prices</b> to lowest priced offer...</i>			
...by same retailer	\$465 to \$565	\$417 to \$574	\$546 to \$779
...by any retailer	\$568 to \$618	\$558 to \$629	\$752 to \$977
<i>Annual savings if switched from <b>most common prices</b> to lowest priced offer...</i>			
...by same retailer	\$51 to \$180	\$45 to \$164	\$62 to \$229
...by any retailer	\$101 to \$183	\$100 to \$224	\$132 to \$486

**Note:** Bills are calculated based on annual consumption of 10,000 kWh, taking into account all available conditional and non-conditional discounts.

**Source:** Electricity retailers and IPART calculations.

### 6.3.3 Prices in regional areas

The Act requires us specifically to consider retail electricity prices for small customers in regional areas.<sup>131</sup> To do so, we assessed differences between prices

<sup>131</sup> *National Energy Retail Law (NSW) (2012)*, s 234A(3b).

in the Essential network area, which represents regional areas of NSW, and prices in the Ausgrid and Endeavour network areas.

### Regional customers can make similar savings to urban customers by shopping around

Sections 6.2.1 and 6.2.2 above show that electricity prices for residential and small business customers tend to be higher in the Essential network area compared with in the Ausgrid and Endeavour areas, primarily due to higher network tariffs on the Essential network. But customers on all networks can make considerable savings from shopping around. Table 6.5 compares the relative savings available to residential and small business customers in each network area.

**Table 6.5 Percentage savings for customers switching from three major retailers' standing offer prices or most common prices in June 2016 by network area (%)**

<b>Residential customers</b>			
	<b>Ausgrid network</b>	<b>Endeavour network</b>	<b>Essential network</b>
<i>Percentage savings if switched from <b>standing offer prices</b> to lowest priced offer...</i>			
<i>...by same retailer</i>	15% to 16%	15% to 18%	13% to 17%
<i>...by any retailer</i>	18% to 20%	21% to 24%	20% to 27%
<i>Percentage savings if switched from <b>most common prices</b> to lowest priced offer...</i>			
<i>...by same retailer</i>	2% to 3%	2% to 3%	2% to 3%
<i>...by any retailer</i>	4% to 8%	7% to 10%	10% to 15%
<b>Small business customers</b>			
	<b>Ausgrid network</b>	<b>Endeavour network</b>	<b>Essential network</b>
<i>Percentage savings if switched from <b>standing offer prices</b> to lowest priced offer...</i>			
<i>...by same retailer</i>	14% to 18%	16% to 21%	15% to 21%
<i>...by any retailer</i>	18% to 19%	21% to 23%	20% to 25%
<i>Percentage savings if switched from <b>most common prices</b> to lowest priced offer...</i>			
<i>...by same retailer</i>	2% to 6%	2% to 7%	2% to 7%
<i>...by any retailer</i>	4% to 7%	4% to 10%	4% to 14%

**Note:** Bills are calculated based on annual consumption of 6,500 kWh for residential customers and 10,000 kWh for small business customers, taking into account all available conditional and non-conditional discounts.

**Source:** Electricity retailers and IPART calculations.

Table 6.5 shows that both residential and small business customers on the Essential network could achieve roughly the same relative savings as customers on the Ausgrid or Endeavour network, if switching from the three major retailers' standing offer prices or most common prices in June 2016.

## 6.4 Changes in underlying costs

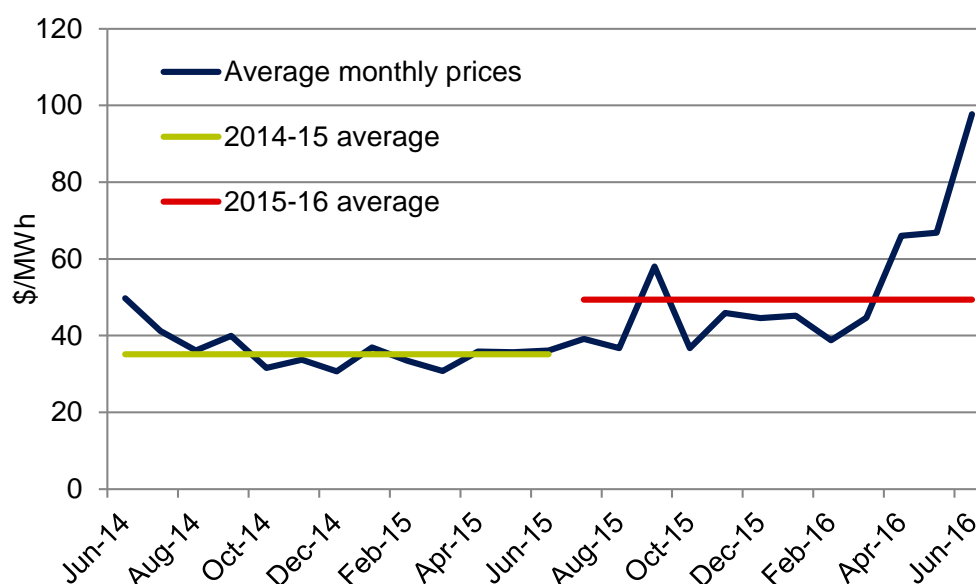
We analysed the changes in the underlying costs of supplying electricity in 2015-16. The analysis used information that is readily available, while also covering the vast majority of a retailer's total costs of supplying electricity. Using this information, we were able to assess changes in:

- ▼ wholesale electricity costs
- ▼ network costs, and
- ▼ green scheme costs.

### 6.4.1 Changes in wholesale electricity costs

To supply their customers, electricity retailers need to purchase wholesale electricity through the National Electricity Market (NEM). Figure 6.7 shows the monthly average spot prices for NSW from June 2014 to June 2016. During 2014-15, the monthly average spot prices remained relatively stable at around \$35/MWh. However, prices increased substantially, by around 40%, in 2015-16, reaching an average of around \$49/MWh.<sup>132</sup>

**Figure 6.7 Monthly average wholesale electricity spot prices in NSW (\$nominal)**



Data source: AEMO, <https://www.aemo.com.au/Datasource/Archives/Archive769>, accessed 25 August 2016.

Spot prices may not reflect retailers' actual exposure to the wholesale electricity market. Retailers generally use a range of exchange-traded and over-the-counter

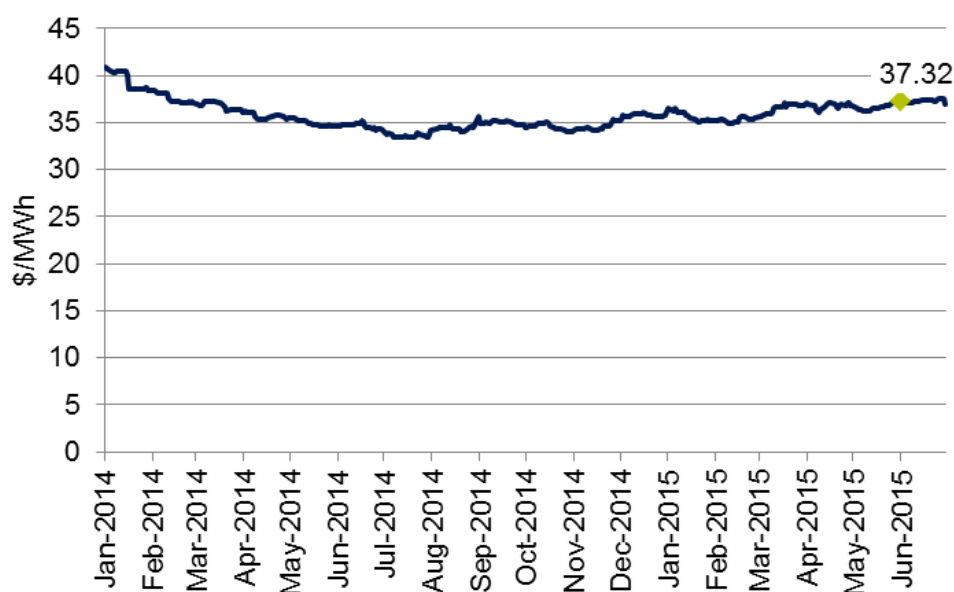
<sup>132</sup> AEMO, *Average annual prices (per financial year)*, at <https://www.aemo.com.au/Datasource/Archives/Archive769>, accessed 25 August 2016.

derivatives to manage price volatility. They also serve small customers who normally have a 'peakier' load profile than the overall system load. This means changes in spot prices may not necessarily reflect changes in retailers' efficient wholesale costs.

Another approach for analysing changes in wholesale electricity prices is to look at electricity futures markets. Electricity futures markets provide information on the market's expectation of the average electricity spot prices for any given year. Since retailers set their electricity prices in advance, looking at futures contract prices for 2015-16 provides useful information about retailers' expected costs of wholesale electricity in 2015-16.

Figure 6.8 shows the Sydney Futures Exchange (SFE) NSW Base Load Electricity Strip prices for 2015-16 from January 2014 to June 2015. These prices provide an indication of the market's expectation for the average electricity price in 2015-16. Note that prices are adjusted to exclude a contract premium of 5%.<sup>133</sup>

**Figure 6.8 NSW Base Load Electricity Strip Futures prices for 2015-16 from 2 January 2014 to 30 June 2015 (\$nominal)**



**Note:** The NSW Base Load Electricity Strip prices are adjusted to exclude our assumed contracting premium of 5%.

**Data source:** Thomson Reuters Eikon.

<sup>133</sup> The contract premium is the difference between expected wholesale contract prices and expected wholesale spot prices. While in principle contract premiums can be either positive or negative, contracts are generally traded at a positive premium to the wholesale spot price. Our assumption of the 5% contract premium is based on advice from Frontier Economics, which we adopted in our various retail electricity price and solar feed-in tariff reviews. Source: IPART, *Solar feed-in tariffs – The subsidy-free value of electricity from small-scale solar PV units in 2015-16 – Final Report*, October 2015, p 9.

The forecast average spot price for 2015-16 was around \$43/MWh in January 2014. While the forecast average prices showed a downward trend in the first six months of 2014, since then they have remained relatively stable at around \$35/MWh to \$37/MWh. This indicates that the market was expecting the average electricity price in 2015-16 to be around \$35/MWh to \$37/MWh.

Retailers generally decide on their prices for the coming financial year in advance, around June each year.<sup>134</sup> As of 1 June 2015, the forecast average spot price for 2015-16 was \$37.32/MWh, implying that retailers could have expected that wholesale electricity spot prices in 2015-16 would be similar to the annual average wholesale electricity price in 2014-15, which was around \$36/MWh. However, contrary to the market's expectation, there was a material increase in the actual wholesale electricity spot prices in 2015-16.

#### 6.4.2 Changes in network prices

In supplying electricity to retail customers, retailers incur network costs, which are the costs of transporting electricity from the generators to customers via the transmission and distribution networks.

The AER regulates electricity network businesses in NSW (ie, Ausgrid, Endeavour Energy and Essential Energy) by setting the annual revenue requirement they can recover from customers via network charges. Electricity retailers do not have control over these prices and pass through network charges in final retail prices. Network charges account for between 40% and 55% of the average household electricity bills in NSW.<sup>135</sup>

In April 2015, the AER released its final decisions on the maximum revenues that the three electricity network businesses would be allowed to earn over the 2015-19 regulatory period. The AER's final decisions were that the network businesses would be allowed to earn 28% to 33% *less* revenue than they had proposed.<sup>136</sup>

Following these decisions, on 1 July 2015 there was a material reduction in network prices for residential and small business customers across all network areas. The impact on total annual electricity bills is likely to have varied depending on the customer's level of consumption. For a typical residential customer with annual consumption of 6,500 kWh, the network costs incurred by retailers in 2015-16 declined by around:

- ▼ 21.0% in the Ausgrid network area

<sup>134</sup> Frontier Economics, *Cost drivers of recent retail electricity prices for small retail customers – A final report prepared for IPART*, November 2016, p 6.

<sup>135</sup> <https://www.aer.gov.au/news-release/aer-finalises-network-charges-in-the-act-and-nsw-from-1-july-2016> accessed 1 September 2016.

<sup>136</sup> AER, *Final decision: Ausgrid (distribution) 2015-19 – Fact sheet*, April 2015; AER, *Final decision: Endeavour Energy (distribution) 2015-19 – Fact sheet*, April 2015; AER, *Final decision: Essential Energy (distribution) 2015-19 – Fact sheet*, April 2015.

- ▼ 14.1% in the Endeavour network area, and
- ▼ 36.2% in the Essential network area.

For typical small business customers with annual consumption of 10,000 kWh, we estimate that the network costs incurred by retailers declined by around:

- ▼ 9.3% in the Ausgrid network area
- ▼ 11.5% in the Endeavour network area, and
- ▼ 29.3% in the Essential network area.

### 6.4.3 Changes in green scheme costs

Retailers also incur costs to meet 'green scheme' obligations including the:

- ▼ Renewable Energy Target (RET), which comprises the Large-scale Renewable Energy Target (LRET) and the Small-scale Renewable Energy Scheme (SRES), and
- ▼ Energy Savings Scheme (ESS).

In general, retailers are required to purchase and surrender a certain number of certificates to meet their obligations under these schemes. For the LRET and SRES, retailers purchase and surrender Large-scale Generation Certificates (LGCs) and Small-scale Technology Certificates (STCs), respectively. For the ESS, retailers purchase and surrender a certain number of Energy Savings Certificates (ESCs).

Figure 6.9 shows that daily spot prices of LGCs increased substantially during 2015-16. LGC's traded around \$52/MWh in early July 2015. Since then prices started increasing sharply, reaching almost \$85/MWh by the end of June 2016.

The substantial increase in the LGC price reflects a likely impending shortfall of LGCs available for purchase by retailers. According to the Clean Energy Council, approximately 3,000 MW of new large-scale projects are required to reach commercial close to start generating LGCs by 2018 to avoid a shortfall. Less than a third of the required projects are waiting for commercial close. These projects would generally require some form of long term agreements such as power purchasing agreements that can provide certainty of revenue to attract sufficient capital investment.<sup>137</sup> However, due to the lack of these long term agreements, capital is not being committed to new projects, causing delays to the new wind and solar projects.<sup>138</sup>

<sup>137</sup> Clean Energy Council, *Progress and status of the renewable energy target*, June 2016, pp 8-9.

<sup>138</sup> <https://energetics.com.au/resources/latest-news/climate-change-matters/large-scale-generation-certificates-part-1> accessed 1 September 2016.



**Figure 6.9** Volume-weighted average spot LGC prices during 2015-16 (\$nominal)



**Note:** The graph excludes days without any trades.

**Data source:** TFS Energy.

Unlike LGC prices, STC prices have not changed at all since July 2015. The prices have remained stable at around the STC clearing house price of \$40. The lowest spot price traded during 2015-16 was \$39.70.

The ESC price increased by around 25% during 2015-16, as shown in Figure 6.10. The volume-weighted average spot price on 1 July 2015 was around \$21/tCO<sub>2</sub>. Since then, the price continued to increase, reaching around \$27/tCO<sub>2</sub> in mid-September 2015. There was a sharp drop in the price in October 2015, but the price quickly recovered to above \$25/tCO<sub>2</sub> and has remained relatively stable since.<sup>139</sup> The increase in ESC prices during this period may have been influenced by the Government's decision to expand the Energy Savings Scheme.<sup>140</sup>

Overall, the cost of complying with green schemes is estimated to account for 6% to 8% of the total costs incurred by retailers in supplying retail electricity.<sup>141</sup> Hence the increase in the prices of LGC and ESC is unlikely to have had a substantial impact on overall retail prices.

<sup>139</sup> An ESC represents 1 tonne of CO<sub>2</sub> equivalent resulting from energy saving activities and is quoted in \$/tCO<sub>2</sub>. \$/tCO<sub>2</sub> is converted to \$/MWh based on: \$/MWh = \$/tCO<sub>2</sub> ÷ 0.94.

<sup>140</sup> <http://www.theaustralian.com.au/business/business-spectator/the-energy-efficiency-certificate-markets-wild-ride-/news-story/bad3bad845b5e9c17db4e13caeed6fa5> accessed 14 September 2016; NSW Government Media Release, *Energy Savings Scheme will reduce living costs*, 13 October 2015.

<sup>141</sup> Frontier Economics, *Cost drivers of recent retail electricity prices for small retail customers – A Final Report prepared for IPART*, November 2016, p 27.



**Figure 6.10 Volume-weighted ESC spot prices (\$nominal)**

**Note:** The graph excludes days without any trades.

**Data source:** TFS Energy.

#### 6.4.4 Retail costs and margin

Retailers incur a range of costs in performing their retail functions. These costs include customer service (eg, operating call centres), billing and collecting revenue, finance, IT systems, regulatory compliance costs, energy trading costs, marketing costs and an appropriate allocation of corporate overheads. Retailers face a range of risks in supplying electricity, including variations in customer demand and economic conditions, and the retail margins also reflect these risks.

Retailers adopt different methodologies for allocating costs and margins which complicates the assessment and comparison of retail costs and margins. Frontier estimates retail costs and margins to account for between 13% to 17% of the total bill faced by electricity customers.<sup>142</sup>

The AEMC reviewed recent studies that analysed retail margins across the NEM.<sup>143</sup> It did not find any evidence suggesting retail margins in jurisdictions with deregulated prices are unreasonably high or inconsistent with a competitive

<sup>142</sup> Frontier Economics, *Cost drivers of recent retail electricity prices for small retail customers – A final report prepared for IPART*, November 2016, p 27.

<sup>143</sup> AEMC, *2015 Residential Electricity Price Trends - Final report*, 4 December 2015; St Vincent de Paul 2015, *The NEM still winging it - observations from Vinnies' tariff tracking project – Final report*, September 2015; CME, *A critique of the Victorian retail electricity market, A report for the Brotherhood of St Laurence*, June 2015; P., Simshauser and P., Whish-Wilson, *Reforming reform: differential pricing and price dispersion in retail electricity markets*, AGL *Applied Economic and Policy Research Working Paper No.49*, June 2015.

market.<sup>144</sup> We expect that over the long term, retail margins would reflect levels appropriate for a competitive market. However, in the short term a retailer's average margin may rise and fall. Importantly, because there are no substantial barriers to entering the retail electricity market in NSW, if high margins exist, we would expect to see new entrants that would compete margins down.

We have found that competition in the electricity retail market is working well, and price movements largely reflect changes in underlying costs. Viewed in conjunction with the AEMC's findings that retail margins are reasonable and are not inconsistent with a competitive market, we do not consider there is a need for a detailed review of retail prices and profit margins.

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<sup>144</sup> AEMC, *2016 Retail Competition Review – Final report*, 30 June 2016, pp 152-156.

## 7 Price movements between June 2016 and September 2016

Earlier this year, retailers announced increases in retail electricity prices from July, with the major retailers increasing their standing offer prices by around 7% to 15%. Following this, the Minister requested that we:

- ▼ analyse the drivers of the recent price increases to ensure that market developments towards the end of 2015-16 are consistent with a competitive market, and
- ▼ assess whether a special review of retail prices and profit margins is required.<sup>145</sup>

In this chapter we assess whether the recent price changes between June 2016 and September 2016 reflect changes in the underlying costs of supplying electricity, as would be expected in a competitive market.

### 7.1 Overview of our finding

Our finding is that the retail price changes between June 2016 and September 2016 reflect changes to the underlying costs of supplying electricity, and are consistent with a competitive market.

We found that the overall cost of supplying electricity in the first quarter of 2016-17 increased by between 11.0% and 16.7% compared with 2015-16. The main cost driver was higher wholesale electricity prices, which have recently increased from historically low levels. The retirement and scheduled maintenance of a number of generators has contributed to these higher wholesale prices. Also contributing to recent retail price changes was higher green scheme costs. The information provided to us by retailers is broadly consistent with these cost drivers, though some retailers indicated an increase in their retail margin has also contributed.

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<sup>145</sup> Submission on IPART's May 2016 fact sheet, *Fact Sheet – 2016 NSW retail electricity market monitoring*, from the Minister for Industry, Resources and Energy, 20 June 2016, p 1, at [https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/pricing-reviews-electricity-submissions-retail-electricity-market-monitoring-2016/online\\_submission\\_-\\_individual\\_-\\_m\\_roberts\\_mp\\_-\\_20\\_jun\\_2016\\_181003439.pdf](https://www.ipart.nsw.gov.au/files/sharedassets/website/shared-files/pricing-reviews-electricity-submissions-retail-electricity-market-monitoring-2016/online_submission_-_individual_-_m_roberts_mp_-_20_jun_2016_181003439.pdf)

Although retail prices increased between June 2016 and September 2016, in many cases these prices are still below June 2015 levels. Residential and small business customers can save substantial amounts by switching from standing offers to retailers' lowest priced offers.

## **7.2 Assessment of price changes between June 2016 and September 2016**

Our assessment involved the following three steps:

1. measuring price changes from June 2016 to September 2016 (including prices in regional areas) – we invited retailers to provide information on their prices and the reasons for their price changes
2. analysing changes in the main underlying costs of supplying electricity over the same period - we engaged Frontier Economics to provide this advice, and
3. assessing whether the price changes reflect changes in the underlying costs of supply.

Similar to our approach for analysing price movements in 2015-16, retailers provided us with information on their standing offer prices and their lowest generally available market offer prices for each network area, and information on the costs contributing to their recent price changes.

## **7.3 Measuring price changes**

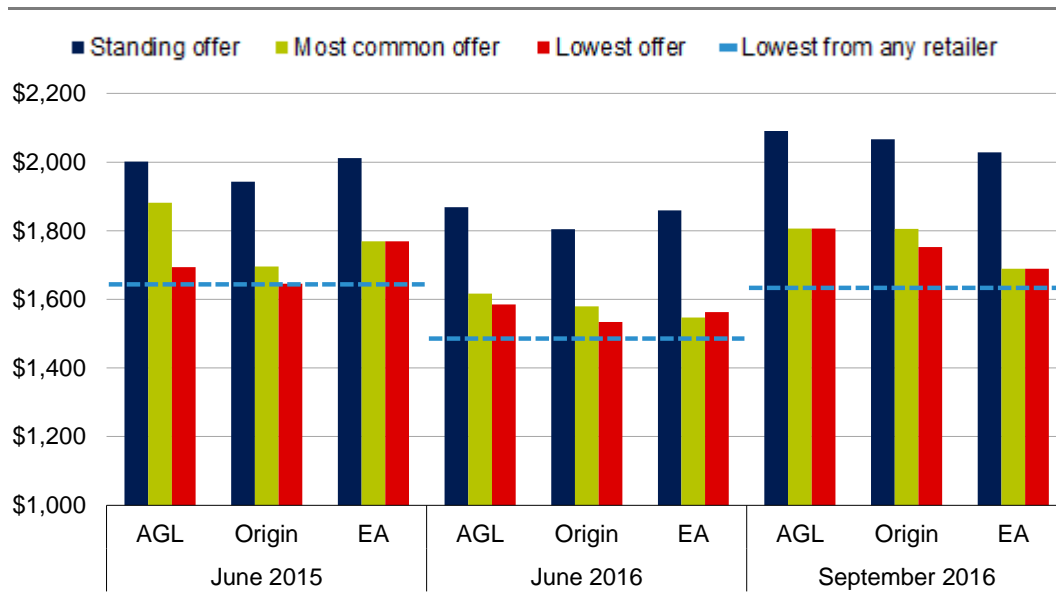
### **7.3.1 Changes in prices for residential customers**

Figures 7.1 to 7.3 compare estimated annual bills for a typical residential customer based on the major retailers' prices in June 2015, June 2016 and September 2016, across each network area. In line with our approach in Chapter 6, we focused on the three main retailers as this represents the majority of small customers in the market. Appendix B shows estimated bills under the standing offer prices, most common tariffs and lowest priced offers for each of the retailers that provided price information to us.

### **Residential offers increased between June 2016 and September 2016**

As per our findings in Chapter 6, Figures 7.1 to 7.3 show that prices for residential customers were substantially lower in June 2016 relative to June 2015. While prices increased between June 2016 and September 2016 across all network areas, in many cases September 2016 prices remained below prices in June 2015.

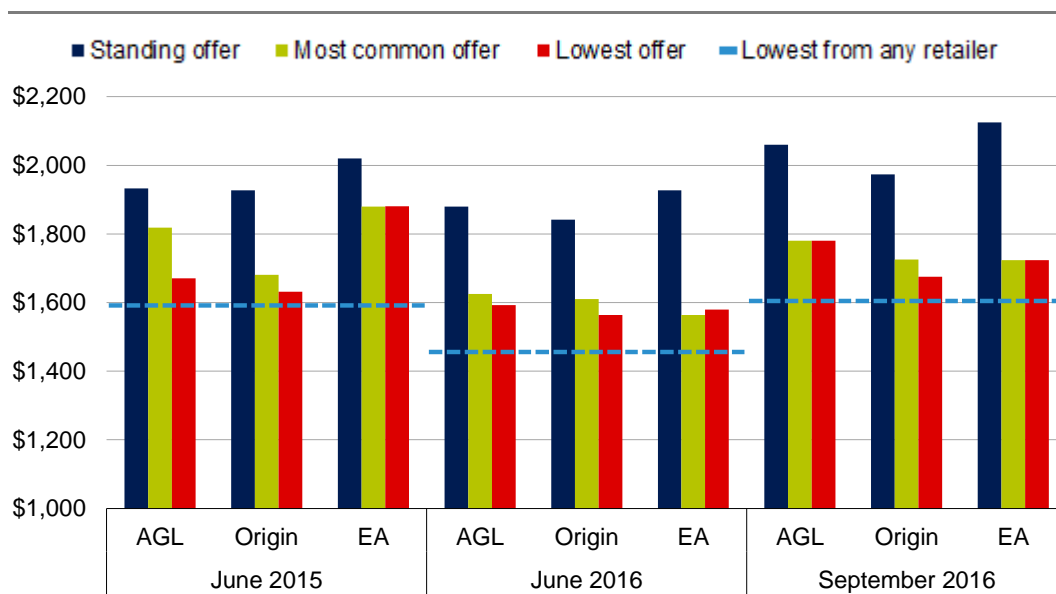
**Figure 7.1** Estimated annual bills on standing offer prices and lowest priced offers for typical residential customers in the Ausgrid network area, June 2015 – September 2016 (\$2016, inc. GST)



**Note:** Bills are calculated based on annual consumption of 6,500 kWh, taking into account all available conditional and non-conditional discounts. The lowest available offers in June 2015, June 2016 and September 2016 were from Dodo, QEnergy and Dodo respectively.

**Data source:** Electricity retailers and IPART calculations.

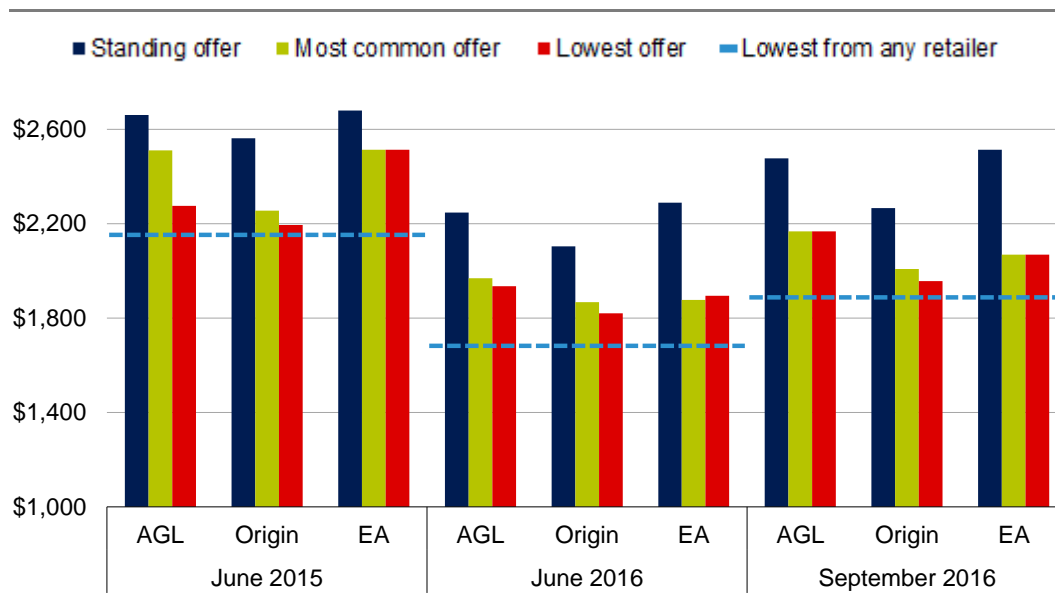
**Figure 7.2** Estimated annual bills on standing offer prices and lowest priced offers for typical residential customers in the Endeavour network area, June 2015 – September 2016 (\$2016, inc. GST)



**Note:** Bills are calculated based on annual consumption of 6,500 kWh, taking into account all available conditional and non-conditional discounts. The lowest available offers in June 2015, June 2016 and September 2016 were from RED Energy, Simply Energy and Dodo respectively.

**Data source:** Electricity retailers and IPART calculations.

**Figure 7.3** Estimated annual bills on standing offer prices and lowest priced offers for typical residential customers in the Essential network area, June 2015 – September 2016 (\$2016, inc. GST)



**Note:** Bills are calculated based on annual consumption of 6,500 kWh, taking into account all available conditional and non-conditional discounts. The lowest available offer in June 2015 was from both Lumo and RED Energy. The lowest offers in June 2016 and September 2016 were from Simply Energy and ActewAGL respectively.

**Data source:** Electricity retailers and IPART calculations.

Table 7.1 presents the ranges of the estimated bill increases in each network area between June 2016 and September 2016. The highest prices tend to be standing offer prices, and for the big three retailers these increased by between 7% and 15% for residential customers.

**Table 7.1** Percentage changes in estimated bills for typical residential customers between June 2016 and September 2016

		Ausgrid network	Endeavour network	Essential network
Three major retailers	% change in standing offer bills	+9% to +15%	+7% to +10%	+8% to +10%
	% change in lowest offer bills	+8% to +14%	+7% to +12%	+7% to +12%
All retailers	% change in standing offer bills	0% to +17%	+4% to +17%	+6% to +18%
	% change in lowest offer bills	+6% to +14%	+5% to +24%	+6% to +20%

**Note:** Bills are calculated based on annual consumption of 6,500 kWh, taking into account all available conditional and non-conditional discounts. The ranges represent our estimated changes in bills on each retailer's standing offer prices and lowest priced offers.

**Source:** Electricity retailers and IPART calculations.

### Residential customers on standing offer prices could make substantial savings in September 2016 by shopping around

While prices increased between June 2016 and September 2016 across all network areas, customers, particularly those on standing offer prices, could make substantial savings by shopping around for a better deal as seen in Figures 7.1 to 7.3.

Table 7.2 shows estimated annual bill savings in September 2016 if a customer switched from standing offer prices by the three major retailers to the lowest priced offer by either the same retailer or from any of the other retailers. For example, in the Ausgrid network area, a typical residential customer on standing offer prices from one of the major retailers could save up to \$339 by switching to the lowest priced offer by the same retailer. The saving would be greater if switched to the lowest priced offer among all the retailers.

**Table 7.2 Potential annual bill savings for residential customers switching from three major retailers' standing offers in September 2016 (\$nominal)**

	Ausgrid network	Endeavour network	Essential network
<i>Annual savings if switched from <b>standing offer prices</b> to lowest priced offer...</i>			
<i>...by same retailer</i>	\$284 to \$339	\$280 to \$401	\$309 to \$445
<i>...by any retailer</i>	\$395 to \$457	\$369 to \$520	\$378 to \$626
<i>Annual savings if switched from <b>most common prices</b> to lowest priced offer...</i>			
<i>...by same retailer</i>	\$0 to \$52	\$0 to \$50	\$0 to \$52
<i>...by any retailer</i>	\$56 to \$173	\$119 to \$175	\$120 to \$280

**Note:** Bills are calculated based on annual consumption of 6,500 kWh, taking into account all available conditional and non-conditional discounts.

**Source:** Electricity retailers and IPART calculations.

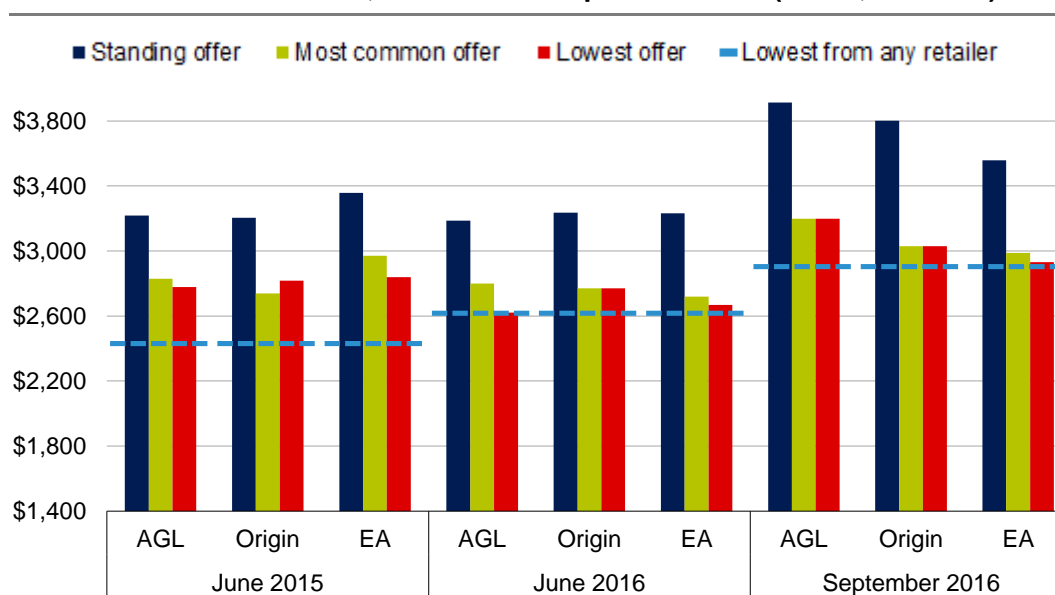
#### 7.3.2 Changes in prices for small business customers

We also compared estimated annual bills for a typical small business customer in each network area based on offers as at June 2015, June 2016 and September 2016. Figures 7.4 to 7.6 show these estimated bills for standing offers, most common tariffs and lowest priced offers from the three major retailers. Appendix B provides the same comparison for all retailers from whom we received price data.

## Prices for small business customers increased between June 2016 and September 2016

The majority of standing offers, most common tariffs and lowest priced offers for small business customers increased by September 2016 compared with June 2016. While these increases often outweighed the decreases in prices observed in 2015-16, in many cases prices remained below June 2015 levels. This was especially true for prices in the Essential network area.

**Figure 7.4** Estimated annual bills on standing offer prices and lowest priced offers for typical small business customers in the Ausgrid network area, June 2015 – September 2016 (\$2016, inc. GST)

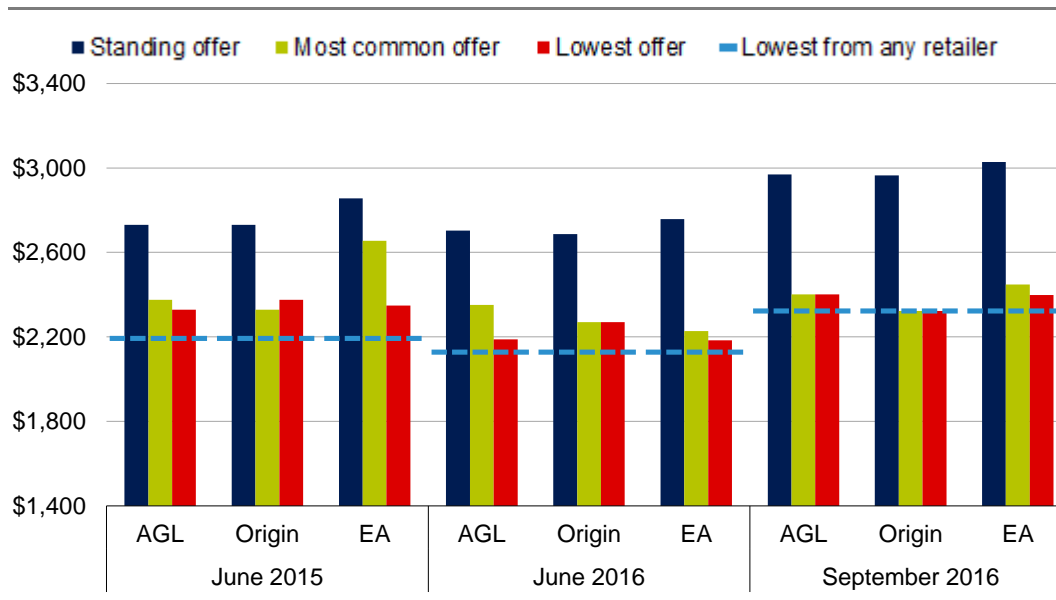


**Note:** Bills are calculated based on annual consumption of 10,000 kWh, taking into account all available conditional and non-conditional discounts. The lowest offers in June 2015, June 2016 and September 2016 were from Simply Energy, 1st Energy and Lumo respectively.

**Data source:** Electricity retailers and IPART calculations.



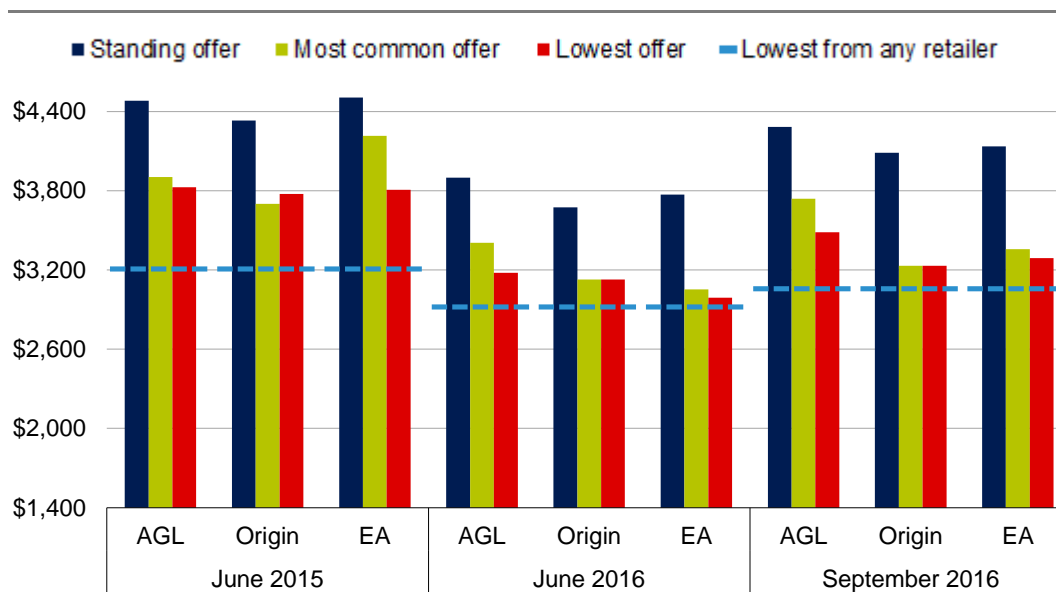
**Figure 7.5** Estimated annual bills on standing offer prices and lowest priced offers for typical small business customers in the Endeavour network area, June 2015 – September 2016 (\$2016, inc. GST)



**Note:** Bills are calculated based on annual consumption of 10,000 kWh, taking into account all available conditional and non-conditional discounts. The lowest offers in June 2015, June 2016 and September 2016 were from Next Business Energy, QEnergy and Origin respectively.

**Data source:** Electricity retailers and IPART calculations.

**Figure 7.6** Estimated annual bills on standing offer prices and lowest priced offers for typical small business customers in the Essential network area, June 2015 – September 2016 (\$2016, inc. GST)



**Note:** Bills are calculated based on annual consumption of 10,000 kWh, taking into account all available conditional and non-conditional discounts. The lowest offers in June 2015, June 2016 and September 2016 were from Lumo, Powershop and Next Business Energy respectively.

**Data source:** Electricity retailers and IPART calculations.

**Table 7.3 Percentage changes in offers for typical small business customers between June 2016 and September 2016**

		Ausgrid network	Endeavour network	Essential network
Three major retailers	% change in standing offer bills	+10% to +23%	+10%	+10% to +11%
	% change in lowest offer bills	+9% to +22%	+2% to +10%	+3% to +10%
All retailers	% change in standing offer bills	-10% to +33%	-13% to +47%	-2% to +22%
	% change in lowest offer bills offers	+2% to +22%	-2% to +37%	0% to +24%

**Note:** Bills are calculated based on annual consumption of 10,000 kWh, taking into account all available conditional and non-conditional discounts. The ranges represent our estimated changes in bills on each retailer's standing offer prices and lowest priced offers.

**Source:** Electricity retailers and IPART calculations.

### Small business customers on standing offers could make substantial savings in September 2016 by shopping around

As was the case for residential customers, small business customers on standing offers in September 2016 could save substantially if they shopped around. Table 7.4 shows estimated bill savings for a typical small business customer switching from a major retailer's standing offer to the lowest priced offer from the same retailer or the lowest priced offer from any of the retailers in September 2016.

**Table 7.4 Potential annual bill savings for small business customers switching from three major retailers' standing offers in September 2016 (\$2016)**

	Ausgrid network	Endeavour network	Essential network
<i>Annual savings if switched from <b>standing offer prices</b> to lowest priced offer...</i>			
...by same retailer	\$627 to \$773	\$568 to \$642	\$797 to \$856
...by any retailer	\$654 to \$1,009	\$642 to \$706	\$1,030 to \$1,225
<i>Annual savings if switched from <b>most common prices</b> to lowest priced offer...</i>			
...by same retailer	\$0 to \$57	\$0 to \$50	\$67 to \$254
...by any retailer	\$84 to \$295	\$78 to \$125	\$174 to \$682

**Note:** Bills are calculated based on annual consumption of 10,000 kWh, taking into account all available conditional and non-conditional discounts.

**Source:** Electricity retailers and IPART calculations.

## 7.4 Retailers' explanations for price changes

We asked retailers to provide information on the drivers of their price changes from July 2016. This information was provided on a confidential basis and so we have not disclosed it for individual retailers. In summary:

- ▼ all retailers reported increases in wholesale electricity costs, network costs and green scheme costs – of these wholesale electricity costs tended to be the largest contributor to price rises, and
- ▼ some retailers reported increases in retail costs and/or retail margin.

While the same cost drivers were identified by retailers, the contribution of these to overall price changes varied. This may reflect different expectations of future wholesale electricity or green scheme costs, for example.

We expect that over the long term, retail margins would reflect levels appropriate for a competitive market. However, in the short term margins may rise and fall. A retailer's average margin may fall during a period of aggressive price discounting in order to win customers and gain market share, and rise again when the campaign is over. Importantly, because there are no substantial barriers to entering the retail electricity market in NSW, if high margins exist, we would expect to see new entrants that would compete margins down.

In the section below we outlined our analysis of cost drivers.

## 7.5 Our assessment of changes in underlying costs

We engaged economic consultants Frontier Economics (Frontier) to examine the cost drivers behind the increases in retail electricity prices from July 2016. In particular, we asked Frontier to:

- ▼ identify relevant cost drivers of retail price changes, and
- ▼ quantify reasonable overall price changes from 2015-16 to 2016-17 for an efficient retailer.

Frontier assessed the drivers of retail electricity price increases, focusing on the various costs that retailers face in supplying electricity to small retail customers. In particular, Frontier:

- ▼ assessed likely changes in each of the main cost categories, mainly wholesale electricity costs, network costs and costs of complying with green schemes,<sup>146</sup> using a number of different approaches, and
- ▼ estimated the overall change in retail electricity prices based on the likely changes estimated in the previous step.<sup>147</sup>

In the sections below, we summarise Frontier's findings. Frontier's full report is available on our website [www.ipart.nsw.gov.au](http://www.ipart.nsw.gov.au).

<sup>146</sup> Since retail operating costs and retail margin account for a relatively small portion of customers' bills, and there is limited information on this available publicly, Frontier did not quantify a percentage change in the retail costs from 2015-16 to 2016-17 for an efficient retailer.

<sup>147</sup> Frontier Economics, *Cost drivers of recent retail electricity prices for small retail customers – A final report prepared for IPART*, November 2016.

### 7.5.1 Wholesale electricity costs

In analysing wholesale electricity costs, Frontier focused on the following two key drivers of changes in wholesale energy costs, which are:

- ▼ **changes in load shape:** Frontier analysed data on the net system load profile for NSW over the last 10 years. Frontier did not find any obvious trend in the net system load profile and concluded that there is no evidence that suggests higher wholesale energy costs are driven by changes in load shape.
- ▼ **changes in spot and contract electricity prices:** Frontier analysed the difference in wholesale electricity prices in 2015-16 and 2016-17, and assessed what this would mean for the change in wholesale energy costs from 2015-16 to 2016-17. To do this, Frontier adopted the following two approaches:
  - comparing *actual* prices for 2015-16 based on AEMO's published spot electricity prices with *expectations* of prices for 2016-17 based on NSW Base Load Electricity Strip prices for 2016-17 published by ASX Energy, and
  - comparing *expectations* of prices for 2015-16 with *expectations* of prices for 2016-17 based on the prices of a mix of different contracts available from ASX Energy.

The remainder of this section focuses on Frontier's analysis of the changes in spot and contract electricity prices.

#### Comparing actual prices for 2015-16 with expectations of prices for 2016-17

AEMO calculated a 2015-16 annual average spot price for NSW of \$49.36/MWh.<sup>148</sup> As of June 2016, the NSW Base Load Electricity Strip price for 2016-17, less a contract premium of 5%, was \$48.64. This forward price implies that on 1 June 2016, which would be around the time retailers would set their retail prices for 2016-17, the market was expecting that the annual average spot price for NSW for 2016-17 would be \$48.64.

Comparing the 2015-16 annual average spot price with the expected 2016-17 average spot price, Frontier concluded that as of 1 June 2016, retailers could have expected little change in the spot prices in 2016-17 compared with the spot prices in 2015-16.

#### Comparing expectations of prices for 2015-16 with expectations of prices for 2016-17

Frontier noted that a drawback of the first approach (ie, comparing actual prices for 2015-16 with expected prices for 2016-17) is that it does not take into account the fact that retailers set prices in advance. It suggested that a more appropriate

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<sup>148</sup> AEMO, *Average annual prices (per financial year)*, at <https://www.aemo.com.au/Datasource/Archives/Archive769>, accessed 25 August 2016.

approach would be comparing expectations of prices for 2015-16 with expectations of prices for 2016-17.

Frontier considered a mix of different contracts available from ASX Energy (ie, peak quarterly swaps, base quarterly swaps, and base quarterly caps), reflecting the fact that retailers tend to use a mix of products to manage their retail load. In particular, it estimated a weighted average price for a mix of contracts<sup>149</sup> and calculated changes from 2015-16 to 2016-17 under the following three approaches:

- ▼ **One day:** using prices on the day closest to the time retailers are likely to make their decisions on retail prices, which is assumed to be 1 June each year.
- ▼ **One month:** using prices averaged over one month leading up to the time that retailers are likely to make their decisions on retail prices (ie, the average from 1 May to 1 June each year).
- ▼ **Two years:** using prices averaged over the two years leading up to the time that retailers are likely to make their decisions on retail prices.

We note that the 'One day' and 'One month' approaches are broadly consistent with the approach we adopted when we regulated retail electricity prices. This is discussed further in section 7.5.5.

**Table 7.5 Percentage increase in wholesale energy costs between 2015-16 and 2016-17 (including inflation)**

	'One day' and 'one month' approaches	'Two years' approach
% increase	27% to 30%	4%

**Note:** Frontier estimated that percentage increases in wholesale energy costs separately across the three network areas in NSW (ie, Ausgrid, Endeavour Energy and Essential Energy) were similar.

**Source:** Frontier Economics, *Cost drivers of recent retail electricity prices for small retail customers – A final report prepared for IPART*, November 2016, p 10.

As shown in Table 7.5, Frontier estimated that the change in wholesale energy costs under the 'One day' and 'One month' approaches was between 27% and 30%. Under the 'Two years' approach, the change in wholesale energy costs was estimated to be 4%.

### Drivers of higher wholesale electricity prices for 2016-17

Frontier noted that there have been a number of retirements of baseload generators along with a number of longer-term scheduled outages of generation plants over the last six months. Examples of recent power station retirements include:<sup>150</sup>

<sup>149</sup> For more details, see Frontier Economics, *Cost drivers of recent retail electricity prices for small retail customers – A final report prepared for IPART*, November 2016, pp 7-8.

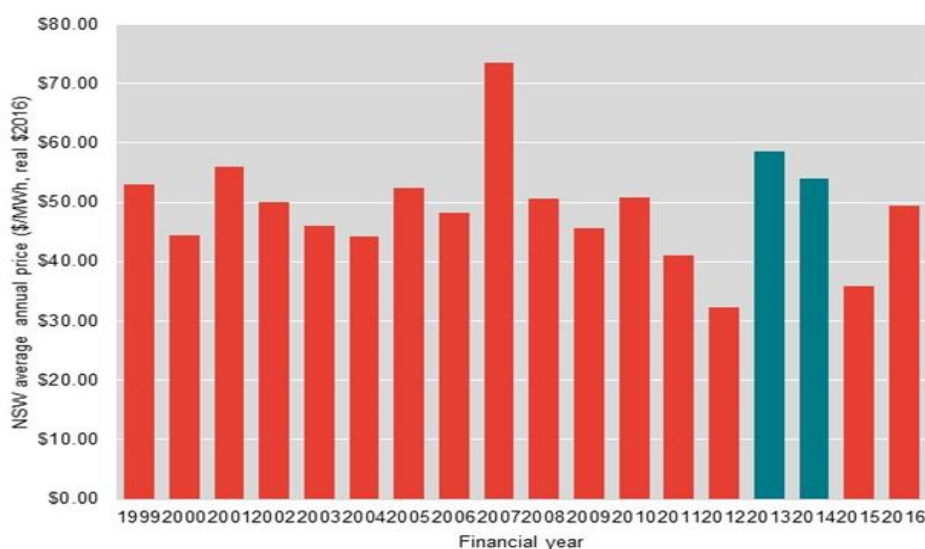
<sup>150</sup> Frontier Economics, *Cost drivers of recent retail electricity prices for small retail customers – A final report prepared for IPART*, November 2016, p 14.

- ▼ in NSW: Munmorah, Wallerawang C, and Redbank, with Smithfield scheduled to retire next year, and
- ▼ in South Australia: Northern Power Station (retired in May 2016).

Because NSW is connected to the NEM, events that take place in other states might flow through to affect prices in NSW and other regions in the NEM to varying extents.

Notwithstanding the factors discussed above, Frontier considers that overall, the recent increase in electricity prices is a sign that spot prices, which were historically low during the period 2011-12 to 2014-15, are reverting to a more typical, longer-term level observed from 1998-99 to 2009-10. This is shown in Figure 7.7.

**Figure 7.7** Average annual NSW regional reference price (\$2016)



**Note:** Prices in 2013 and 2014 include the carbon price.

**Data source:** Frontier Economics, *Cost drivers of recent retail electricity prices for small retail customers – A final report prepared for IPART*, November 2016, p 14.

## 7.5.2 Network costs

Retailers incur network costs in supplying electricity to retail customers, which are the costs of transporting electricity from the generators to customers via the transmission and distribution networks.

Consistent with the approach used in Chapter 6, Frontier calculated the costs incurred by retailers in supplying a typical small retail customer in NSW based on the 2015-16 and 2016-17 network prices published by Ausgrid, Endeavour Energy and Essential Energy. See Chapter 2 for information on the 2016-17 network prices in NSW. Frontier estimated that across the three network areas,

network tariffs for primary load increased by between 2% and 6% from 2015-16 to 2016-17. The change in network tariffs for controlled load was estimated to be between -1% and 2% over the same period.

### 7.5.3 Costs of complying with green schemes

To estimate changes in the costs of complying with green schemes, Frontier used a similar approach to that used to estimate changes in wholesale electricity costs. However, since there are no reliable forward prices for green schemes, Frontier used actual spot prices of LGC and STC as a proxy for expected certificate prices for 2016-17.

Using prices for LGCs and STCs and their corresponding Renewable Power Percentage (RPP) and Small-scale Technology Percentage (STP), Frontier estimated the change in the cost of complying with green schemes from 2015-16 to 2016-17. The cost of complying with the LRET was estimated to have increased by around 90%. The increase was driven by higher LGC prices and an increase in the RPP set by the Commonwealth Government under section 40 of the *Renewable Energy (Electricity) Act 2000*.<sup>151</sup> In contrast, the cost of complying with the SRES decreased by nearly 10% from 2015-16 to 2016-17 as a result of flat STC prices and a reduction in the STP.<sup>152</sup>

Frontier provided possible reasons for the increase in LGC prices from 2015-16 to 2016-17. While large retailers typically obtain the majority of their LGCs through long term agreements such as power purchasing agreements with wind generators, some businesses facing a shortage of LGCs may be acquiring LGCs through the spot market instead, placing upward pressure on LGC spot prices. In addition, there may have been delays in renewable investments in recent years driven by political uncertainty and this may be reflected in higher spot prices.<sup>153</sup>

### 7.5.4 Retail costs

In addition to wholesale electricity costs, network costs and costs of complying with green schemes, retailers also incur retail costs (retail operating costs and retail margin). Given that these costs account for a relatively small portion of the total costs incurred by a retailer and the lack of publicly available information, Frontier did not quantify a percentage change in the retail costs from 2015-16 to 2016-17 for an efficient retailer.

<sup>151</sup> <http://www.cleanenergyregulator.gov.au/RET/About-the-Renewable-Energy-Target/The-certificate-market/The-renewable-power-percentage> accessed 14 September 2016.

<sup>152</sup> Frontier Economics, *Cost drivers of recent retail electricity prices for small retail customers – A final report prepared for IPART*, November 2016, p 20.

<sup>153</sup> Frontier Economics, *Cost drivers of recent retail electricity prices for small retail customers – A final report prepared for IPART*, November 2016, p 18.



As discussed in section 6.4.4, the AEMC found no evidence that suggests retail margins in NSW are unreasonably high or inconsistent with a competitive market.<sup>154</sup>

### 7.5.5 Estimates of overall cost changes

Based on the likely changes in each cost component estimated under the three approaches, Frontier calculated changes in the total cost of supplying electricity to retail customers. It adopted ranges for the proportion of total costs accounted for by each component, informed by data from the most recent price trends report from the AEMC.

Table 7.6 shows Frontier's estimated ranges for changes in total costs in supplying electricity to retail customers across NSW from 2015-16 to 2016-17, under the three approaches.

**Table 7.6 Frontiers' estimated changes in total supply cost from 2015-16 to 2016-17**

	One day	One month	Two years
Total cost	11.2% to 16.7%	11.0% to 16.1%	4.4% to 5.7%

**Source:** Frontier Economics, *Cost drivers of recent retail electricity prices for small retail customers – A final report prepared for IPART*, November 2016, p 28.

In our view, the likely change in the total cost of supplying electricity to retail customers from 2015-16 to 2016-17 would be in the range of 11.0% to 16.7%. This is based on the results from the 'One day' and 'One month' approaches, which are broadly consistent with the approach we adopted when we regulated retail electricity prices. In regulating electricity prices, we used contract prices based on a point-in-time estimate rather than a rolling average. A point-in-time approach reflects retailer's decisions around what retail price to offer customers should reflect expectations of the cost of supplying that customer and not the consequences of prior decisions.<sup>155</sup>

<sup>154</sup> AEMC, *2016 Retail Competition Review – Final report*, 30 June 2016, pp 152-156.

<sup>155</sup> See IPART, *Review of regulated retail prices and charges for electricity from 1 July 2013 to 30 June 2016 – Final Report*, June 2013, pp 70-71.



## 8 Rivalry and diversity

The final two competition indicators we assessed were:

- ▼ rivalry between retailers – the extent to which they are competing to attract and retain customers, and
- ▼ price and product diversity – whether this diversity is consistent with a competitive market.

We assessed these indicators together because they are related. In a competitive market, retailers need to compete with their rivals to attract and retain customers. The primary way they do this is by marketing their products and services and competing on price and non-price components of their market offers. Therefore, in a competitive market, we would expect to see active rivalry between retailers and a range of different price and service offerings to meet the needs of customers.

In the sections below we summarise our findings on rivalry and product diversity and provide further information on our assessment.

### 8.1 Overview of our finding

Our finding is that there is evidence of both strong rivalry between retailers and a substantial increase in the range of products and services available to customers. In our view this is consistent with competitive market that is working well.

Price is the most common way that retailers attract and retain customers and through 2015-16 retailers offered substantial price discounts. However, the largest percentage discount does not necessarily represent the lowest priced offer, as the reference rate can vary across retailers and plans. This means that to find the lowest priced offer, customers are likely to need price comparator tools like the [energymadeeasy.gov.au](http://energymadeeasy.gov.au) website, which allows them to search for the offer that provides the lowest bill, based on their consumption information. Retailers also use non-price features to attract and retain customers. In the last 12 months there has been an increase in innovation in market offers.

We consider the outlook for the retail electricity market is increasingly dynamic as emerging technologies are further refined and respond to customers' demand for more efficient and cost-effective energy solutions that give them greater savings, convenience, flexibility, transparency and control over their energy usage. This includes offers that allow customers to engage more with their energy use and have more control over their bills.

## 8.2 Assessing rivalry and price and product diversity

To make our assessment, we considered retailer surveys conducted for the AEMC's 2016 competition review, analysed the market offers available on the [energymadeeasy.gov.au](http://energymadeeasy.gov.au) website, and took account of various media releases and reports made throughout the year.

## 8.3 Retailers' perception of independent rivalry

Retailers surveyed for the AEMC's competition review mostly rated the degree of rivalry in the NSW electricity market as 'high'. There was a marked increase in retailers' perception of price competition in NSW, which was given a 'high' ranking in 2016, elevated from 'moderate' in 2015. Smaller retailers have commented on incumbent retailers' aggressive customer 'win-back' campaigns, offering large discounts to retain their customer base, making it challenging for second tier retailers to expand their market share.<sup>156</sup> Non price rivalry remained constant at a moderate level.<sup>157</sup>

## 8.4 Price diversity

In 2015-16, retailers continued to offer substantial discounts as they did in the previous year. However, the largest percentage discount does not necessarily represent the lowest priced offer, as the reference rate can vary across retailers and plans. This means that to find the lowest priced offer, customers are likely to need price comparator tools like the [energymadeeasy.gov.au](http://energymadeeasy.gov.au) website, which allows them to search for the offer that provides the lowest bill, based on their consumption information.

<sup>156</sup> Ferrier Swier Consulting, *2016 Energy Retailer Survey – Report for the Australian Energy Market Commission*, 30 March 2016, p 57.

<sup>157</sup> Non price rivalry refers to a range of non-price incentives such as renewable generation, customer service guarantees, provision of real time energy usage data, rewards programs such as frequent flyer points.

Based on offers on the [energymadeeasy.gov.au](http://energymadeeasy.gov.au) website and price data supplied to us by retailers, we found that market contracts offer a range of discounts from a reference rate or other price related incentives to attract and/or retain customers, for example:

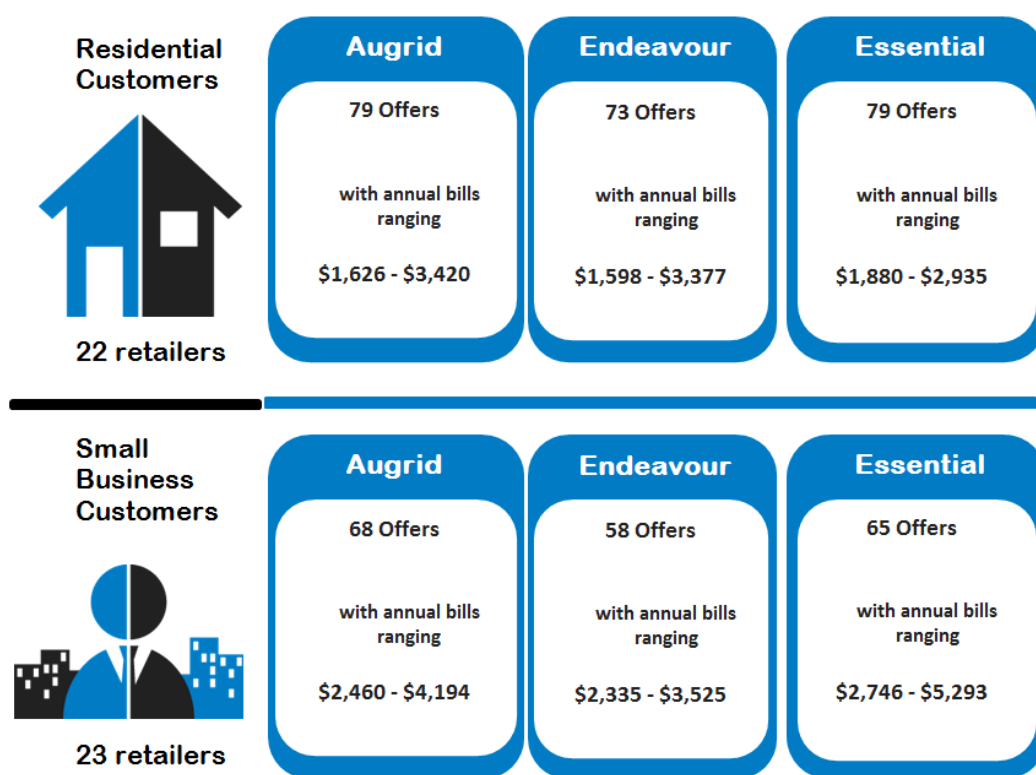
- ▼ One-off switching incentive, such as \$50 upfront credits on first bill and/or up to 2 months of free supply charge.
- ▼ Conditional discounts including pay on time, dual fuel bundled promotion, direct debit discounts.
- ▼ Guarantees on fixed rate usage or supply charges. Eg, No electricity rate rises for two years, guaranteed.<sup>158</sup>

Figure 8.1 below shows the number of offers (including standing offers) available to residential and small business customers in each network area of NSW, as at 11 November 2016. It also shows the range in estimated annual bill amounts, assuming that all available discounts are received. The estimated annual bill amounts were calculated using the [energymadeeasy.gov.au](http://energymadeeasy.gov.au) billing tool. Note that this analysis includes many more offers than considered in our analysis of price changes in Chapters 6 and 7.

Both the number of electricity offers and the range of prices available have increased across all networks in NSW relative to our analysis last year. This is likely due to the higher number of retailers contesting the market, and the wider range of energy products and services catering for different market segments.

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<sup>158</sup> Origin Energy Residential Rate Freeze (Single Rate) ORI189818MR and EnergyAustralia's Rate Fix - Home - Peak Only ENE167793MR

**Figure 8.1 Summary of retailers' market offers as at 11 November 2016**

**Note:** Estimated annual bills are based on annual average usage of around 6,500 kWh for residential customers and 10,000 kWh for small business customers and include all available discounts. Results assume that customers have a single rate tariff and do not have controlled load for their hot water or other appliances.

**Data source:** EnergyMadeEasy, <https://www.energymadeeasy.gov.au/>, accessed 11 November 2016.

## 8.5 Product diversity

Our research indicates a greater degree of product differentiation in the market over the last year. The key trends are targeted at greater savings through bundled products and services, predictability in billing, transparency in pricing, convenience and control over household usage and renewable energy.

### 8.5.1 New and emerging products and services

Over 60% of retailers surveyed for the AEMC reported launching new products and services in NSW retail market.<sup>159</sup> Survey results suggest that NSW was leading product innovation within the NEM over the last two years; this is consistent with the AEMC's finding that NSW is an attractive first entry point for new entrants and rivalry is one of the most intense in the NEM.<sup>160</sup>

<sup>159</sup> Ferrier Swier Consulting, 2016 *Energy Retailer Survey – Report for the Australian Energy Market Commission*, 30 March 2016, p 55.

<sup>160</sup> AEMC, 2016 *Retail Competition Review*, 30 June 2016, p 20.

### Innovative energy pricing models

Retailers are increasingly offering an alternative to the traditional tariff structure to appeal to different market segments. For example, earlier this year Origin Energy launched a lock-in energy contract aimed at removing 'bill shock'.<sup>161</sup> Customers who value predictability and control over their energy bills can pay an agreed fixed amount on their utility bills each fortnight or month provided they do not go over their agreed usage for a 12-month period.<sup>162</sup>

For customers that prefer flexibility in their energy billing, Powershop offers a pricing model that gives customers more transparency and the ability to plan and budget for their energy usage and bills. Powershop allows customers to pre-purchase units of energy when it's convenient and offers periodic sales and discounts so cost-conscious energy users can lower their average unit costs by buying electricity for coming months.<sup>163</sup> This gives customers the option to manage cash flow and smooth out energy costs more evenly throughout the year. Households fitted with smart meters can further benefit from automatic real-time price signals about their electricity usage from their smart phones.<sup>164</sup>

Mojo Power introduced a new pricing model that works on a flat monthly subscription, giving customers access to wholesale energy rates and apps to track their energy usage in real time with a smartphone.<sup>165</sup> Mojo Power's model varies from the traditional pricing model of charging per kilowatt of energy usage. Instead, Mojo Power sells electricity at 'wholesale cost' and profits from monthly subscription fees.<sup>166</sup> Mojo Power's premium packages also include free installation of a smart meter upgrade.

### Renewable and smart home energy products and services

In 2015-16, a common trend in product innovation related to smart meters, solar PV, battery and other energy storage solutions.<sup>167</sup> Several energy retailers have partnered with Tesla Energy to provide an integrated rooftop solar system with

<sup>161</sup> S. Elsworth, Origin Energy to offer fixed price contracts for gas and electricity usage. <http://www.news.com.au/finance/business/other-industries/origin-energy-to-offer-fixed-price-contracts-for-gas-and-electricity-usage/news-story/8272ae411a1d25b69748fcf2b58b8dc5>, accessed 16 September 2016.

<sup>162</sup> <https://www.originenergy.com.au/blog/lifestyle/predictable-plan-pay-the-same-amount-for-energy-every-month.html>, accessed 16 September 2016.

<sup>163</sup> <http://www.powershop.com.au/toolkit/> To accurately calculate each unit price, Powershop spread your daily charge over your average usage (using a three month rolling average). <http://blog.powershop.com.au/powershop-pricing-explained/>, accessed 16 September 2016.

<sup>164</sup> <http://www.powershop.com.au/mobile-apps/>, accessed 16 September 2016.

<sup>165</sup> <http://www.mojopower.com.au/energypass-benefits/>, accessed 16 September 2016.

<sup>166</sup> Your subscription to a fairer energy deal, <http://www.mojopower.com.au/energypass-benefits/>, accessed 16 September 2016.

<sup>167</sup> Ibid.

battery storage solution. For example, Origin Energy<sup>168</sup>, EnergyAustralia<sup>169</sup> and Simply Energy<sup>170</sup> are marketing the Daily Powerwall either as a standalone storage solution or as a complete solar power system.

Another area likely to develop in the near future is ‘smart homes’. Smart homes are households fitted with demand management devices that can be programmed to automatically shut off non-critical appliances, such as a pool filter, or to cycle appliances such as an air-conditioner or refrigerator, on and off in periods of high demand. There are technological applications that allow individuals to control their energy usage and home appliances remotely. Smart home applications also have the potential to further enhance capacity value of solar through a combination of load shifting, demand response and integrated storage system.<sup>171</sup>

Urth Energy and Enova Energy are new entrants that offer 100% green power. Enova Energy is the first community-owned renewable energy retailer. Enova members and shareholders are committing 50% of profits to assist low income households to transition to low cost renewables, including solar options for landlords and renters.<sup>172</sup>

In August 2016, the NSW government launched the Advanced Energy Strategy and invited industry experts in the NEM to take part in developing a roadmap for the State to transition to a clean, affordable and reliable energy future.<sup>173</sup> Key objectives are to connect alternative energy sources and other technologies to the grid, and to identify opportunities and reduce barriers for NSW consumers to access the benefits and cost savings that can be gained from emerging technologies like solar, battery storage, smart meters and energy management services.<sup>174</sup>

### Bundled energy products and services

Retailers are also increasingly innovative in repackaging energy services to attract customers. For example, Commander Power & Gas offers small business

<sup>168</sup> <https://www.originenergy.com.au/blog/big-picture/origin-launch-first-solar-battery-offering-with-the-tesla-powerw.html>, accessed 1 August 2016.

<sup>169</sup> <https://www.energyaustralia.com.au/residential/home-services/batterystorage>, accessed 1 August 2016.

<sup>170</sup> <https://www.simplyenergy.com.au/home/energy-solutions/battery-storage/>, accessed 1 August 2016.

<sup>171</sup> E. Wesoff, SolarCity’s CTO Peter Rive on Solar Power plus Energy Storage <http://www.greentechmedia.com/articles/read/SolarCitys-CTO-Peter-Rive-on-Solar-Power-Plus-Energy-Storage>, accessed 8 August 2016.

<sup>172</sup> <http://www.enovaenergy.com.au/about/>

<sup>173</sup> <http://www.resourcesandenergy.nsw.gov.au/landholders-and-community/public-comment/advanced-energy-strategy>, accessed 10 August 2016.

<sup>174</sup> NSW Government Media Release, ‘NSW to develop Advanced Energy Strategy’ 3 August 2016.

customers the ability to deal with a single company for all of their business services - office phone, mobile, broadband, data technologies and electricity.<sup>175</sup>

Overseas experience suggests that interest in combining energy services with telecommunication and solar installation could be significant. This industry direction may offer opportunities for utilities, solar installers and telecoms to increase their revenue streams and market penetration through bundled products.<sup>176</sup>

### 8.5.2 Early termination fees

Fees can influence a customer's decision to switch energy options and retailers. The AEMC reported that some vulnerable customers cited concerns about potential exit and disconnection fees as a reason to not investigate other energy options.<sup>177</sup>

In recent years, there has been a move away from fixed term and lock in contract periods. Since price deregulation in NSW, many retailers have removed early termination fees (ETFs) from most of their offers. For those offers that include an ETF, some included additional benefits such as a fixed rate benefit period, higher discounts compared to other generally available market offers, or non-price incentives such as access to proprietary rewards programs. The offers with higher ETFs tend to offer a greater percentage price discount or other upfront incentives, relative to those offers without ETFs.

Table 8.1 shows the range of ETFs in market offers available on [energymadeeasy.gov.au](http://energymadeeasy.gov.au) on 28 November 2016 for residential customers on single-rate meters. It shows there is a mix of different ETFs in market offers. From a total of 229 offers across the three distribution areas, 47 offers (or 21%) included an ETF. Customers that prefer market contracts without ETFs could choose from 79% of available offers in late November 2016.

Currently, a component of ETFs is subject to caps under the National Energy Retail Rules (NSW).<sup>178</sup> In 2013, IPART was asked by the NSW Government to set these caps. In our Final Report in December 2013, we set caps of:

- ▼ \$130 within 12 months of the date of first supply, and

<sup>175</sup> Commander Electricity was launched in NSW in March 2014. <https://www.commander.com.au/electricity/about-cpg> accessed 22 June 2016.

<sup>176</sup> According to research conducted by Parks Associates released at the Smart Energy Summit in Austin USA, February 2015: 'Nearly half of homes with broadband in the U.S. are willing to subscribe to a bundle of energy services for about \$USD10 per month. Internet and HVAC maintenance were the most popular services to bundle with electricity services.' <http://www.greentechmedia.com/articles/read/consumers-hungry-for-bundled-energy-services-survey-finds>

<sup>177</sup> AEMC 2016 Retail Competition Review: Section 6.3.3 at p 51.

<sup>178</sup> These caps do not include the monetary costs to the retailer of any upfront inducements offered to the customer.

- ▼ \$45 thereafter (until the end of the fixed term contract or fixed benefit period of a market retail contract).<sup>179</sup>

These amounts exclude GST and the monetary value to the retailer of any upfront inducement costs.

**Table 8.1 Residential offers with early termination fees on 28 November 2016**

	Ausgrid No of offers	Endeavour No of offers	Essential No of offers
Total residential offers in EnergyMadeEasy	79	72	78
Offers with no ETF	64	56	62
Offers with ETFs	15	16	16
ETFs between \$20-\$30 (incl GST)	4	4	4
ETFs between \$90-\$99 (incl GST)	5	6	6
ETFs of \$143.50 (incl GST) <sup>a</sup>	6	6	6

<sup>a</sup> Simply Energy was the only retailer to include this ETF amount in some of its offers in each network area.

**Note:** Based on single rate residential offers with no controlled load in each network area. Postcodes used were Ausgrid (2000), Endeavour (2541) and Essential (2650). The range of ETFs noted in the table is for the first year of a contract. ETFs are often lower in subsequent years.

**Source:** Energy Made Easy website and IPART calculations.

Since the majority of market offers now either don't include an ETF or have ETFs well below these caps, we consider that competition is providing a better form of protection for customers relative to regulated ETF fee caps. In our view, regulation of ETFs is no longer needed.

PIAC does not support this recommendation, and argues instead that ETFs should be banned altogether. If ETFs are not banned, PIAC considers the caps should remain as a safety net for consumers.<sup>180</sup>

Since the majority of market offers now either do not include an ETF, or have ETFs well below the current caps, we consider that competition is providing a better form of protection for customers. We also consider that banning ETFs would reduce choice for consumers unnecessarily. Similar to mobile and internet providers, electricity retailers often offer better tariffs to customers who are willing to commit for a minimum period. Banning ETFs would give retailers no incentive to make such offers available.

We therefore maintain our recommendation that regulation of ETFs should be discontinued. Submissions from EnergyAustralia and AGL support this recommendation.<sup>181</sup>

<sup>179</sup> IPART, *Early termination fees – regulating the fees charged to small electricity customers in NSW – Final Report*, December 2013, p 2.

<sup>180</sup> PIAC, *A competitive market to benefit all – IPART Review of the performance and competitiveness of the retail electricity market in NSW*, 27 October 2016, p 5.

<sup>181</sup> EnergyAustralia submission to Draft Report, 27 October 2016, p 3; and AGL submission to Draft Report, 27 October 2016, p 1.



#### Recommendation

- 2 That price regulation of early termination fees caps under the National Energy Retail Rules (NSW) be removed as the competitive market is providing a more effective means of protecting customers.





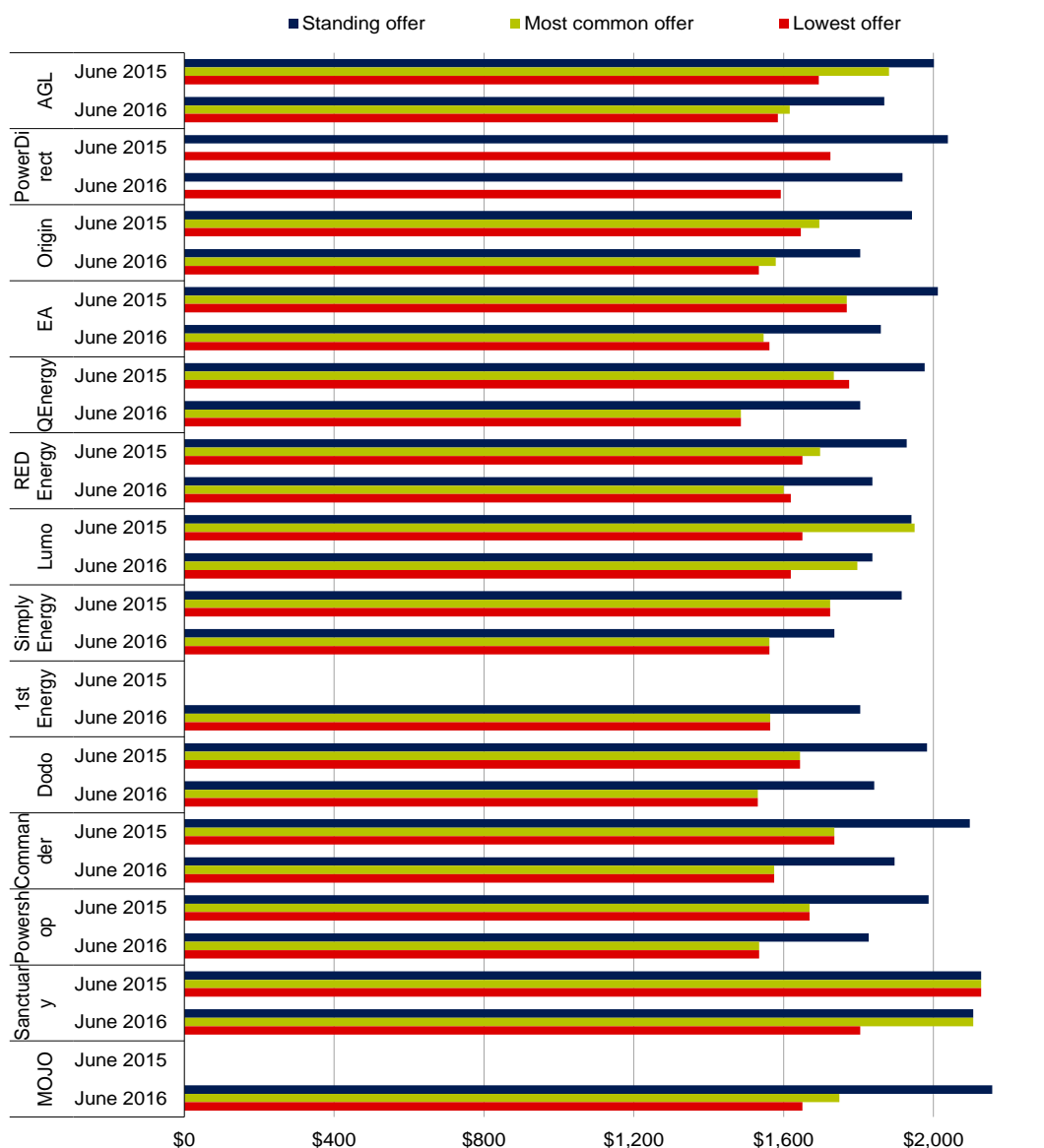
## Appendices



## A Price changes in 2015-16

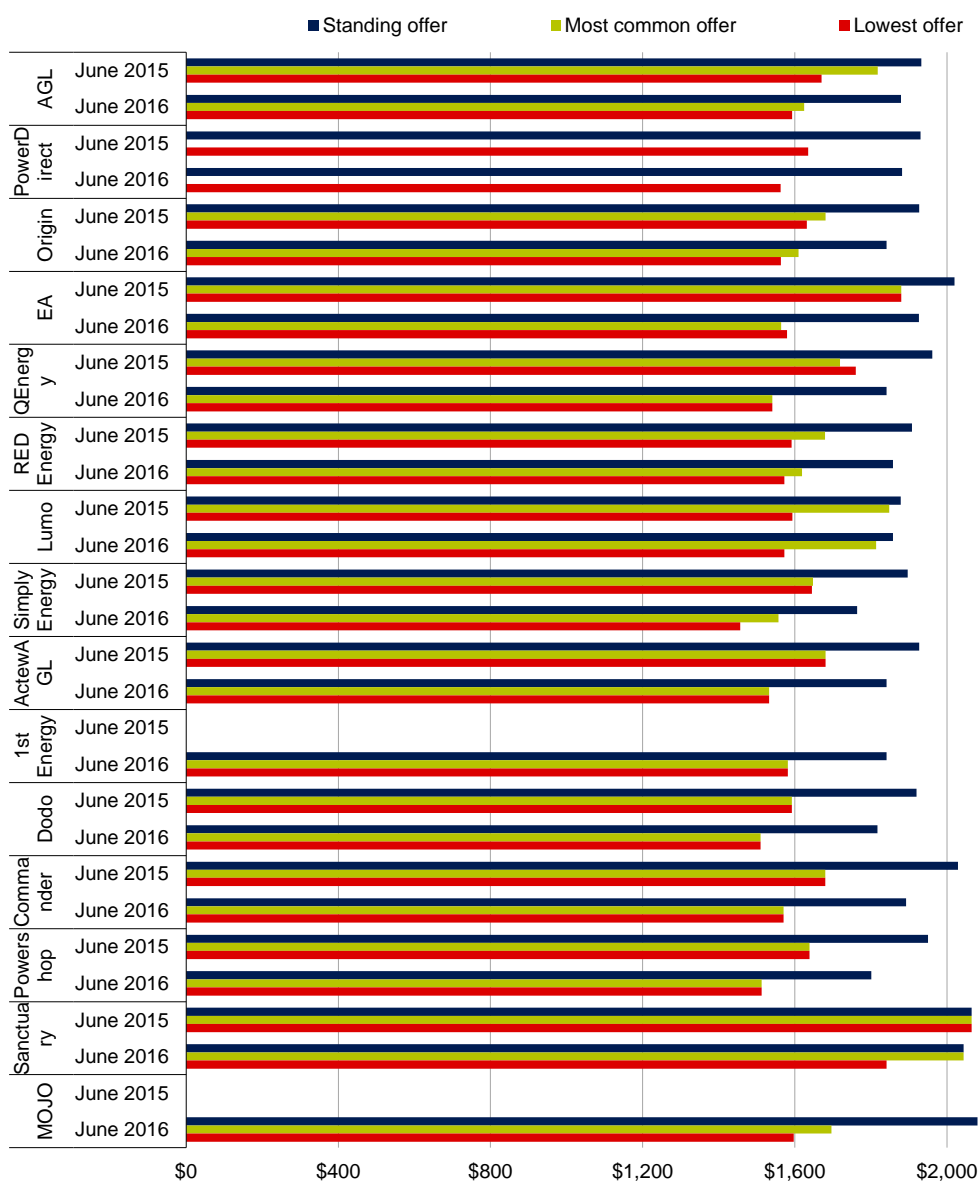
### A.1 Residential customers

**Figure A.1 Ausgrid network area (\$2016)**

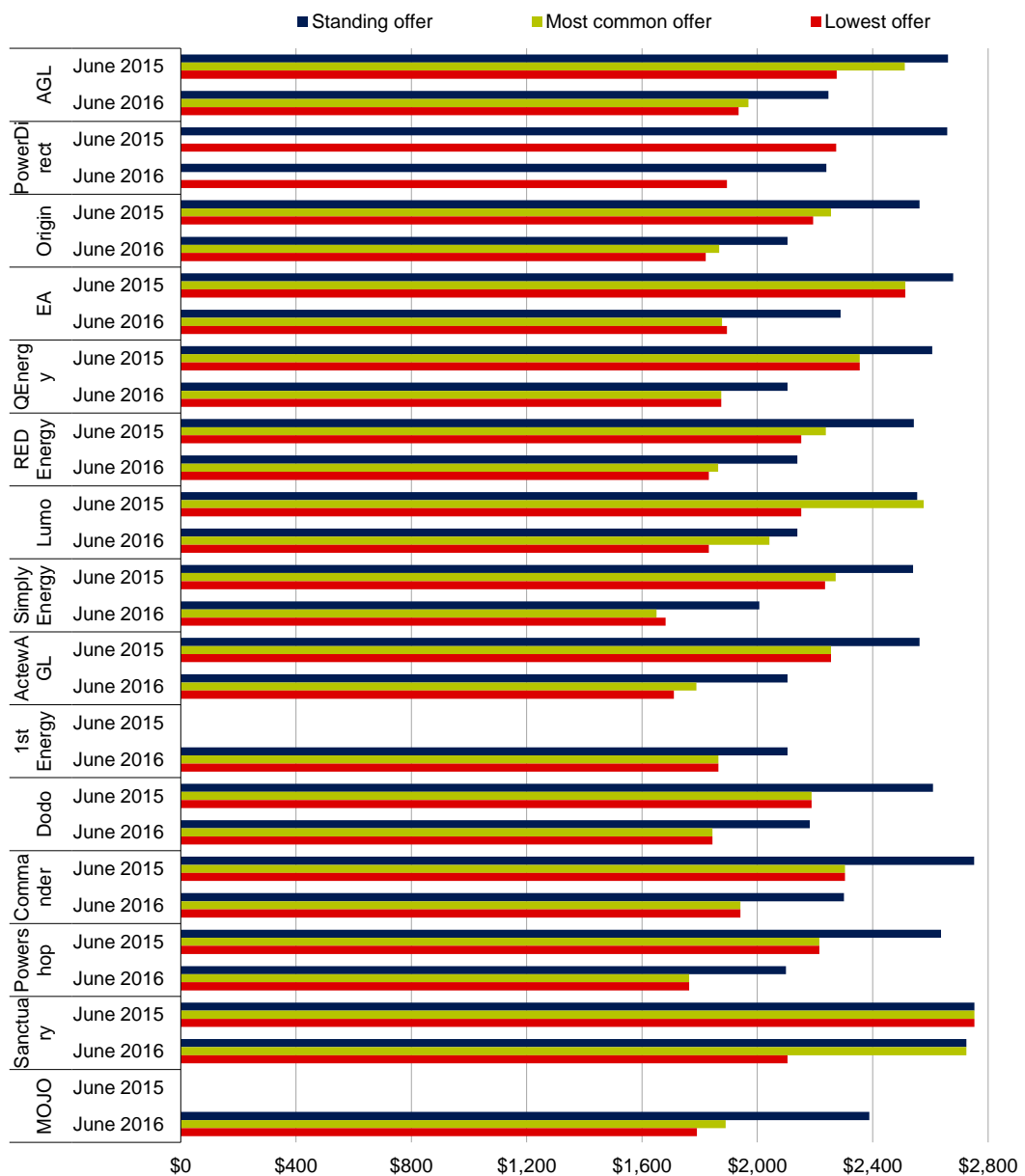


**Data source:** Electricity retailers and IPART calculations.

**Figure A.2 Endeavour Energy network area (\$2016)**



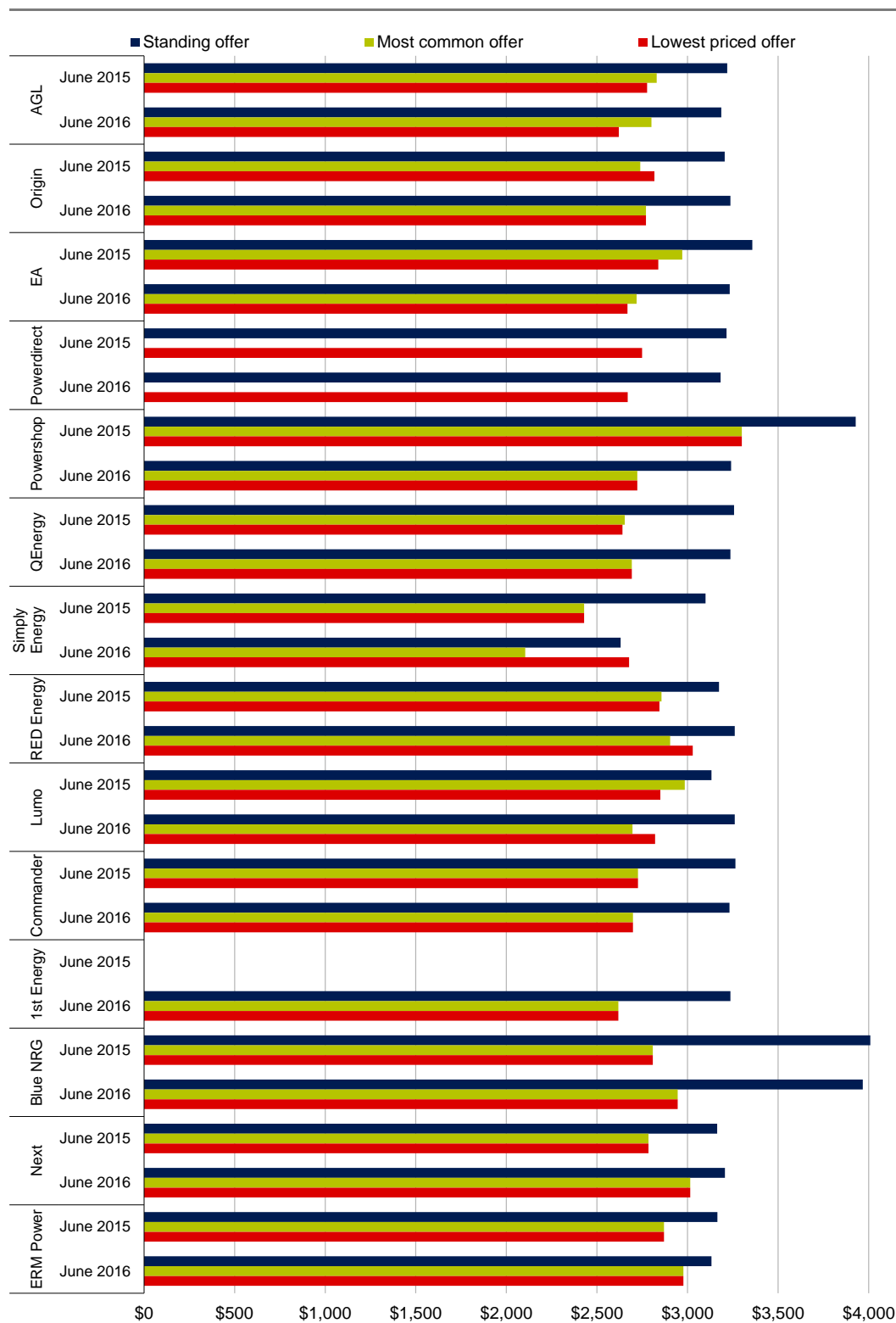
**Data source:** Electricity retailers and IPART calculations.

**Figure A.3 Essential Energy network area (\$2016)**

Data source: Electricity retailers and IPART calculations.

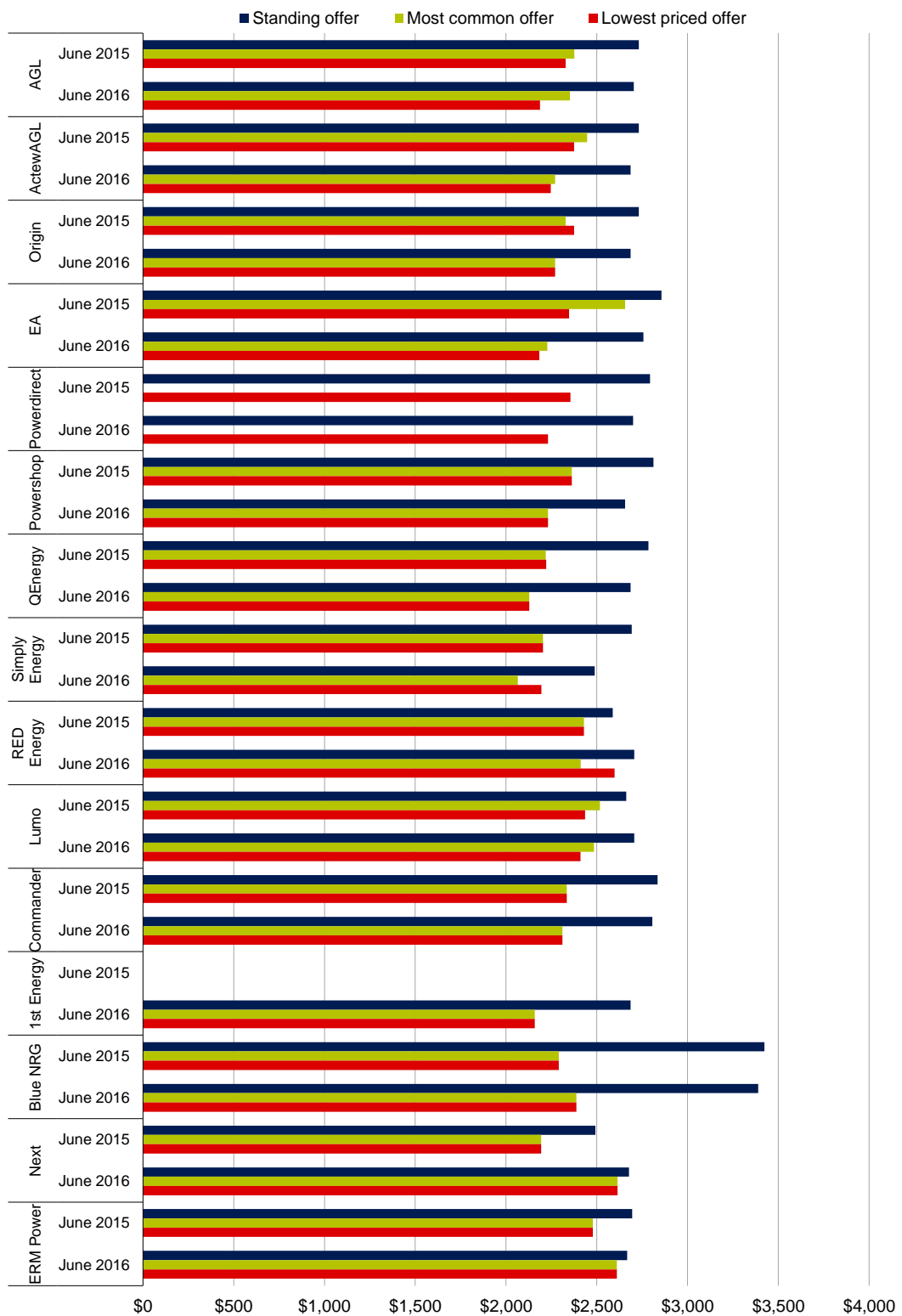
## A.2 Small business customers

**Figure A.4 Ausgrid network area (\$2016)**



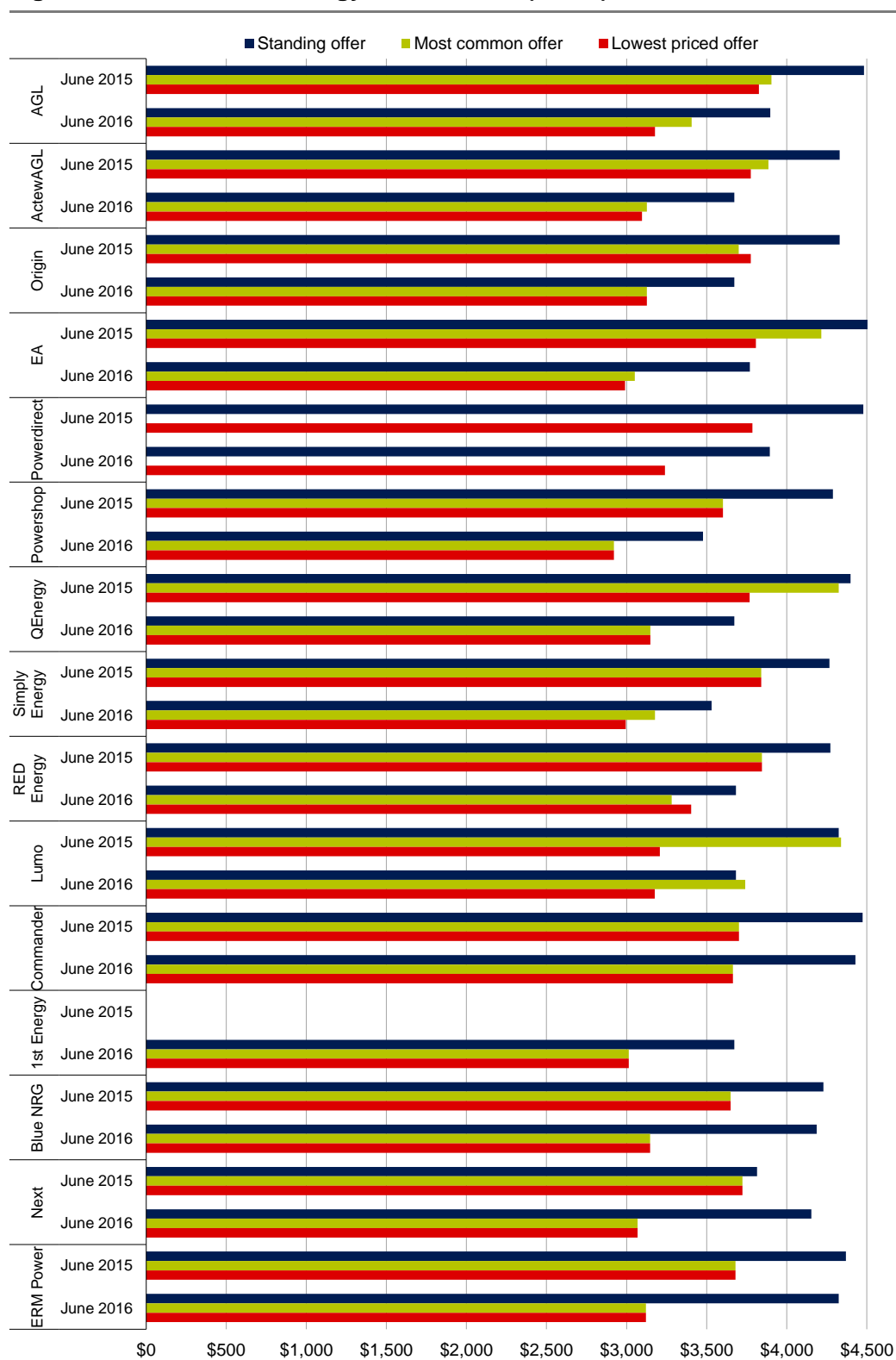
Data source: Electricity retailers and IPART calculations.



**Figure A.5 Endeavour Energy network area (\$2016)**

Data source: Electricity retailers and IPART calculations.

**Figure A.6 Essential Energy network area (\$2016)**

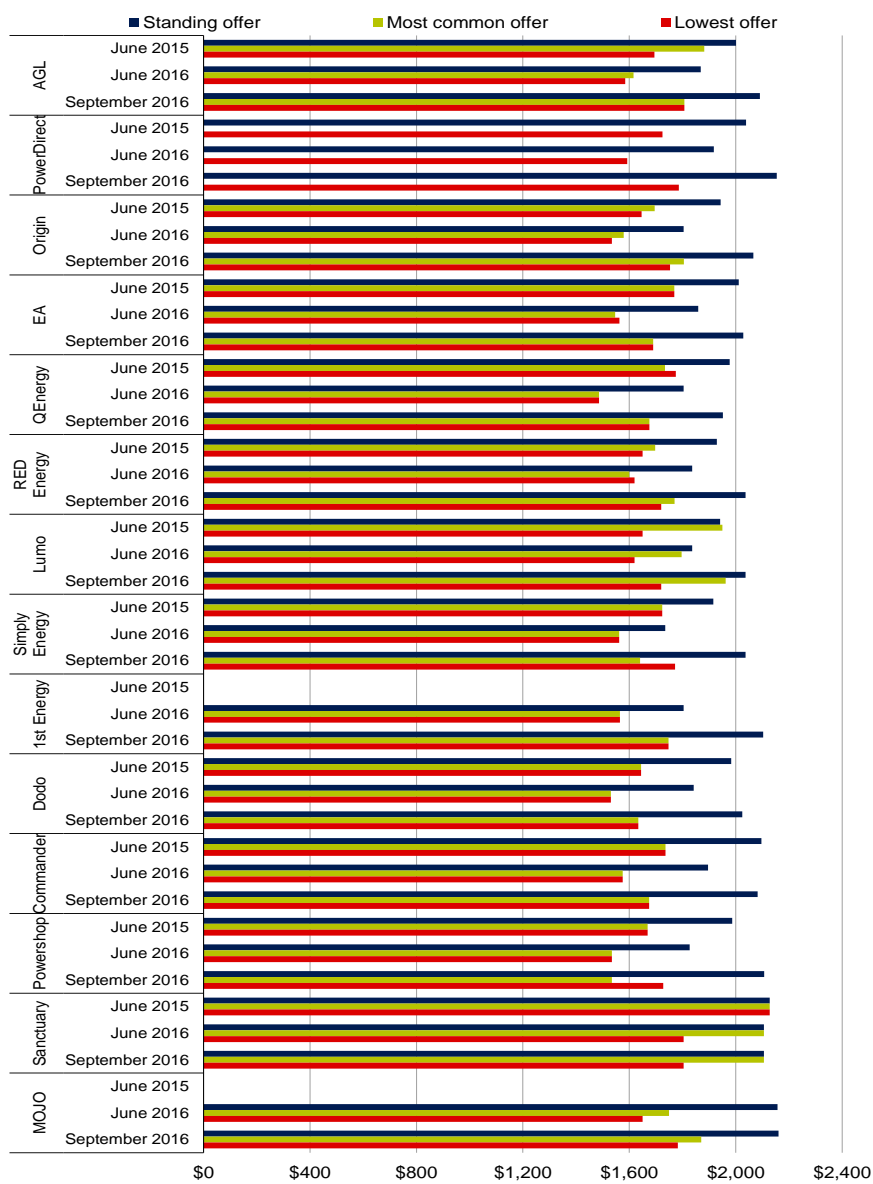


**Data source:** Electricity retailers and IPART calculations.

## B Price changes from June 2015 to September 2016

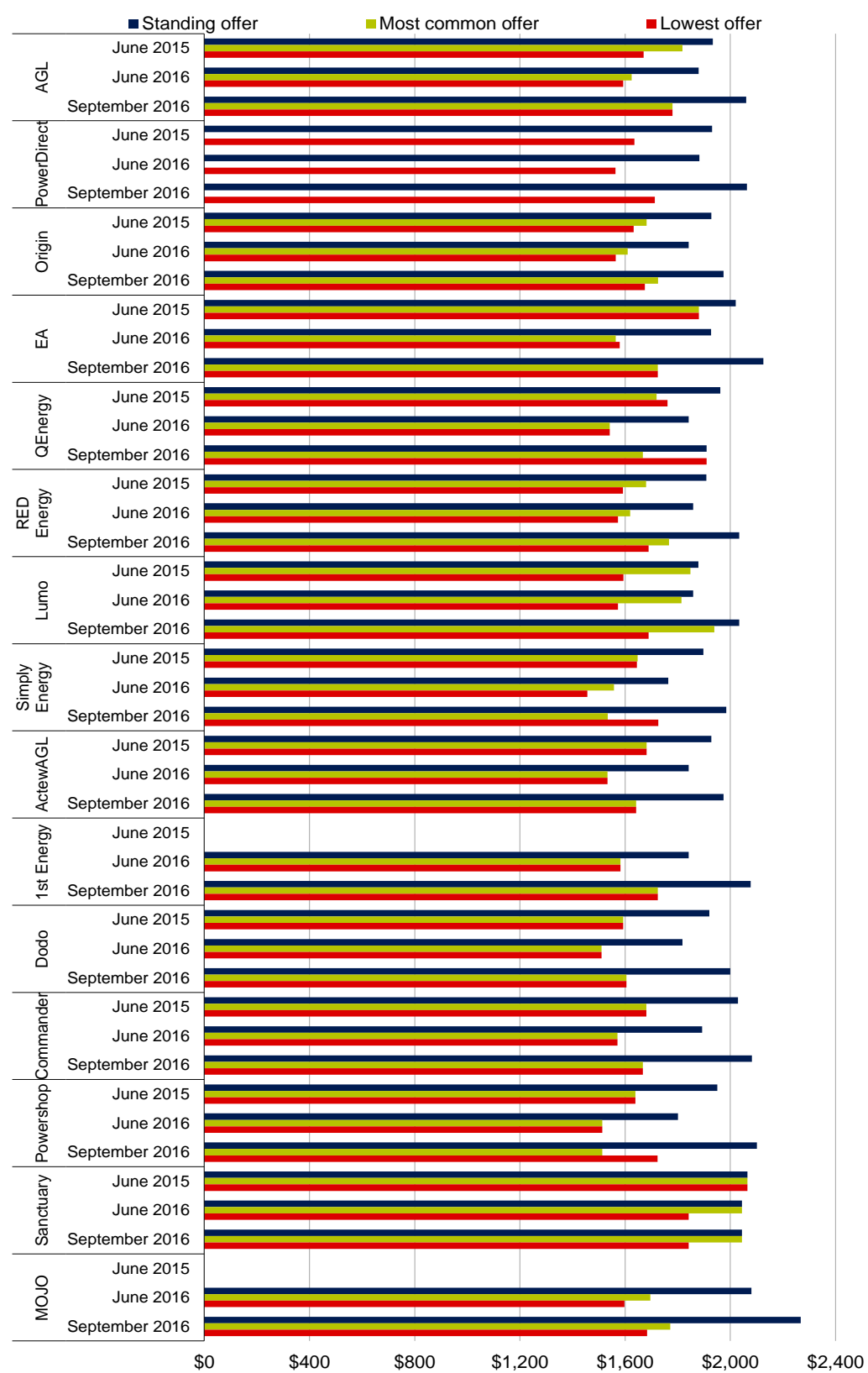
### B.1 Residential customers

**Figure B.1 Ausgrid network area (\$2016)**

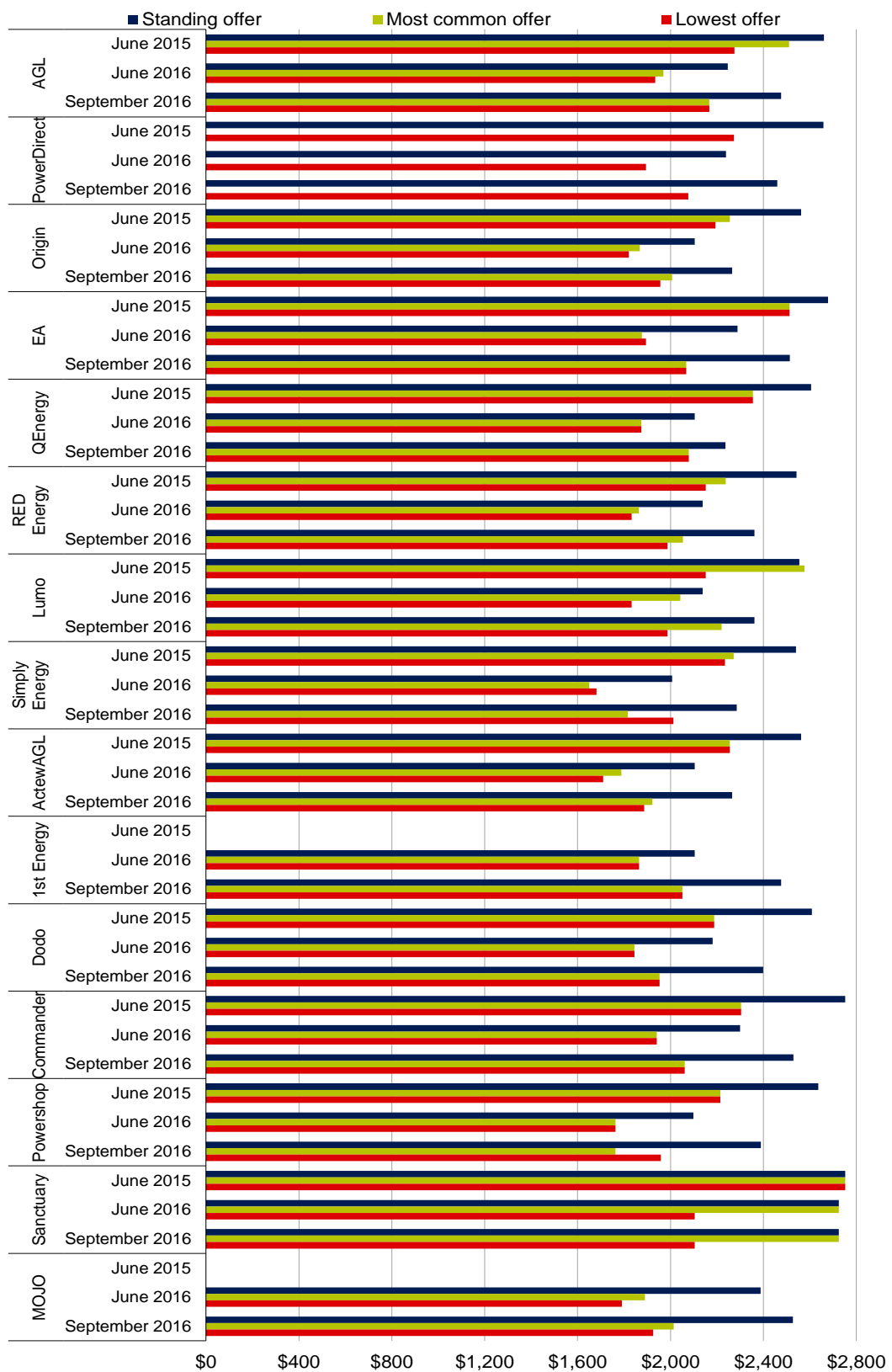


Data source: Electricity retailers and IPART calculations.

**Figure B.2 Endeavour network area (\$2016)**



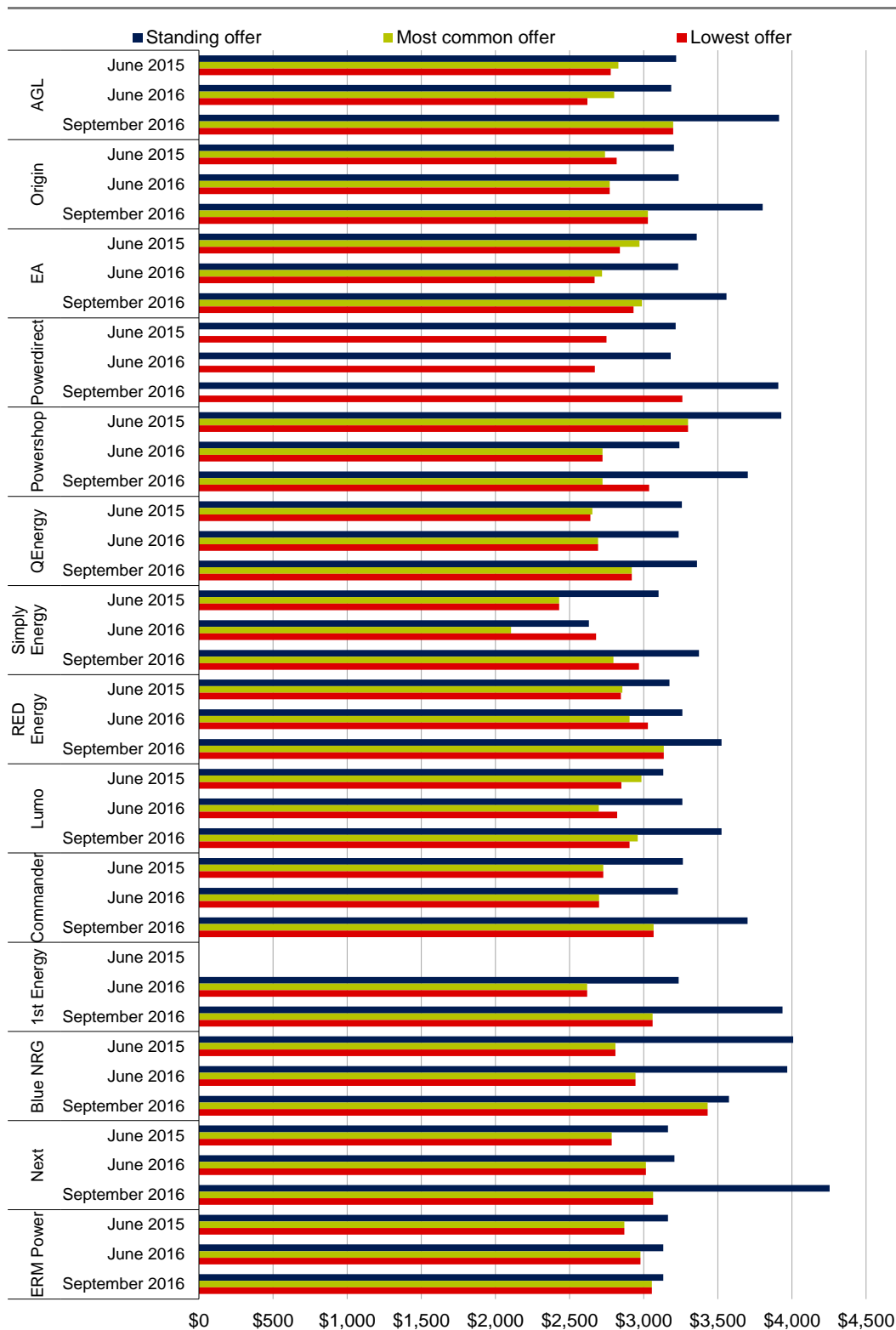
Data source: Electricity retailers and IPART calculations.

**Figure B.3 Essential network area (\$2016)**

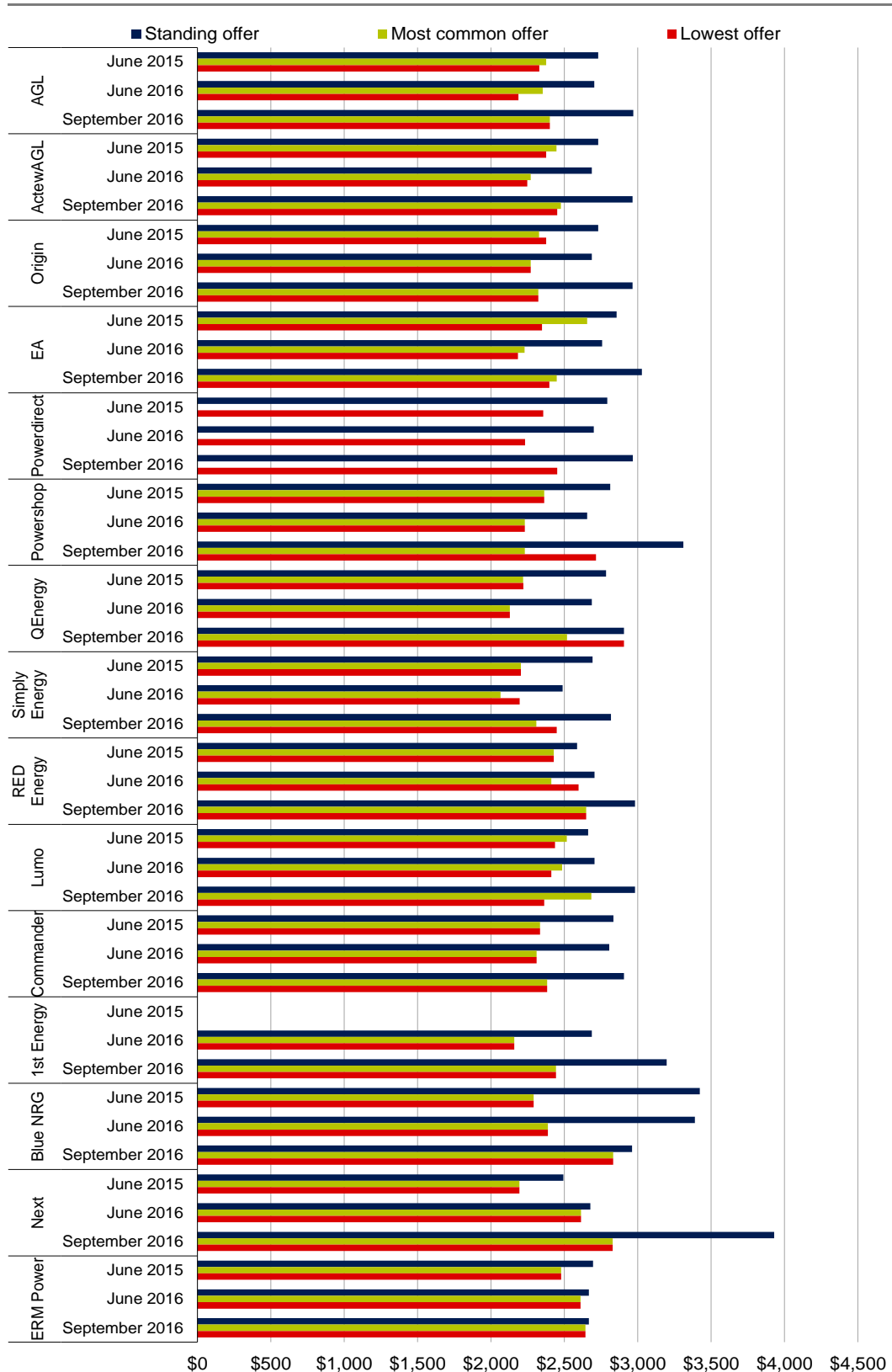
Data source: Electricity retailers and IPART calculations.

## B.2 Small business customers

**Figure B.4 Ausgrid network area (\$2016)**

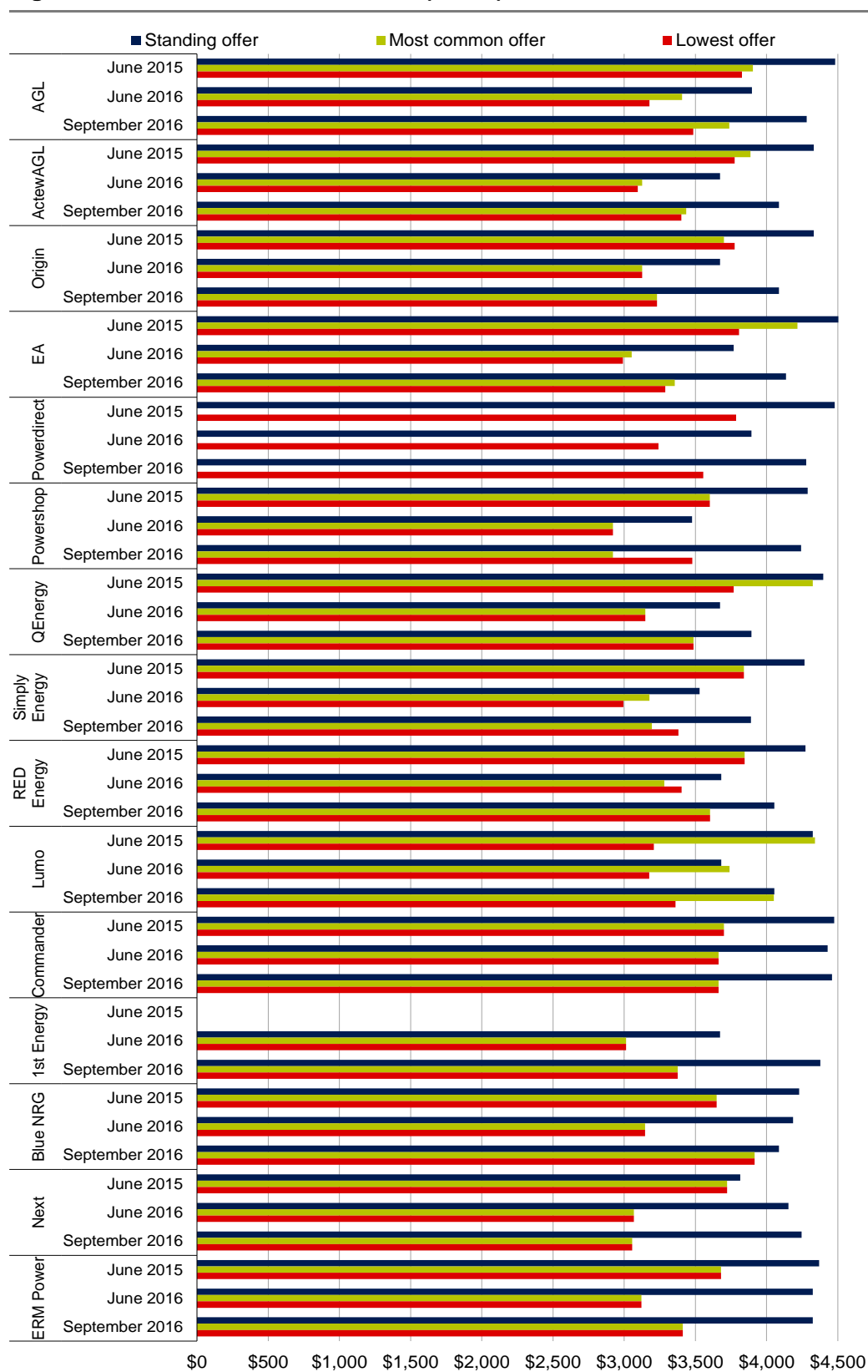


Data source: Electricity retailers and IPART calculations.

**Figure B.5 Endeavour network area (\$2016)**

Data source: Electricity retailers and IPART calculations.

**Figure B.6 Essential network area (\$2016)**



Data source: Electricity retailers and IPART calculations.