



Australian Energy Market Commission

**Review of the Effectiveness of Competition in  
Gas and Electricity Retail Markets**

Issues Paper

1 June 2007

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## **About the AEMC**

The Council of Australian Governments, through its Ministerial Council on Energy, established the Australian Energy Market Commission (AEMC) in July 2005 to be the Rule maker for national energy markets. The AEMC is currently responsible for Rules and policy advice covering the National Electricity Market. It is a statutory authority. Our key responsibilities are to consider Rule change proposals, conduct energy market reviews and provide policy advice to the Ministerial Council as requested, or on AEMC initiative.

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## Abbreviations

AEMA	Australian Energy Market Agreement
AEMC	see Commission
Commission	Australian Energy Market Commission
ESC	Essential Services Commission
FRC	Full retail competition
MCE	Ministerial Council on Energy
NEM	National Electricity Market
NGL	National Gas Law

## Executive Summary

The ongoing energy market reforms continue to introduce important changes to the structure and operation of Australian energy markets. The commitment of the Commonwealth and the States and Territories to these reforms is reflected in the terms of the Australian Energy Market Agreement (AEMA). One of the commitments made by each of the signatories is to review the effectiveness of competition in the retail markets for natural gas (gas) and electricity for the purpose of retaining, removing or reintroducing retail price regulation (retail competition reviews).<sup>a</sup>

The AEMA requires the Australian Energy Market Commission (Commission) to undertake a retail competition review in each jurisdiction participating in the National Electricity Market (NEM) and the National Gas Law (NGL) and to publicly report the results. In April 2007, the Ministerial Council on Energy (MCE) advised the Commission that the reviews would be conducted sequentially, commencing with the retail gas and electricity markets of Victoria (Victorian Review).<sup>b</sup> The MCE has also identified high level criteria to be applied by the Commission in conducting the reviews.<sup>c</sup>

The release of this Issues Paper marks the commencement of the Victorian Review. Each of the retail competition reviews, including this Victorian Review, will have a direct influence on policy decision making for the regulatory frameworks that will apply to retail markets for gas and electricity in the future. The Commission is required to finalise its review of the effectiveness of competition in Victoria by the end of February 2008. This Issues Paper is the first step in that process and it seeks comment on aspects of retail energy competition and the experience of energy customers that are specific to the Victorian market.

The Victorian Government has progressively introduced choice for retail electricity and gas customers in separate tranches, commencing with the largest electricity and gas customers in 1994 and 1999 respectively<sup>d</sup> until the choice of energy supplier was introduced in 2002 for the final tranche of household and small business customers.<sup>e</sup> At each stage of introducing competition, safety net arrangements have been applied that include reasonable prices and terms and conditions to enable a smooth transition until competition is effective in delivering these outcomes. The final tranche of contestable customers are the only remaining group to have access to tariffs that apply under the safety net arrangements.

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a Australian Energy Market Agreement (AEMA), clause 14.11(a).

b Letter dated 19 April 2007 from the Chair of the MCE, The Hon Ian Macfarlane MP to Dr John Tamblyn, Chairman of the Australian Energy Market Commission.

c Letter dated 17 November 2006 from the Chair of the MCE, The Hon Ian Macfarlane MP to Dr John Tamblyn, Chairman of the Australian Energy Market Commission.

d The timetable for the introduction of full retail competition in Victoria is set out in Table 3.1 of Chapter 3.

e The final tranche of customers were those that consumer less than 160MWh of electricity or less than 5TJ of gas per annum.

The purpose of the Victorian Review, and the subsequent retail competition reviews, is to assess whether competition is effective for small customers and to make recommendations in relation to the retention or removal of the tariff component of the safety net arrangements. Where competition is found to not be effective the Commission is to provide recommendations on how competition can be improved.

At the time of industry disaggregation in the mid-1990s, the electricity retail businesses were initially integrated with the distribution network businesses serving the same areas, while in gas the retail businesses were established as separate corporate entities but stapled to the distribution business.<sup>f</sup>

At the time of the introduction of full retail competition (FRC) in Victoria there were five incumbent electricity retailers and three gas retailers. Following a series of acquisitions three host retailers currently exist for both electricity and gas. They are TRUenergy, AGL Energy and Origin Energy. The introduction of FRC has encouraged new entrant retailers to offer gas or electricity in competition with the incumbent retailers. In 2004 the Essential Services Commission (ESC) conducted a review of the effectiveness of competition in Victoria which found that retail competition in gas and electricity supply was generally effective for those groups where sufficient profit margin existed. The ESC concluded that although general market offers were being made to all small customers, the offers made to low margin customers were not attractive relative to the standing offer price. While the Commission will collect and analyse current market data and information on the effectiveness of retail market competition, it will have regard to the ESC's findings where they provide an indication of trends and of the evolution of the market.

On 19 April 2007 the Commission published its Statement of Approach which outlined the manner in which the Commission would assess the effectiveness of competition and consider the criteria established by the MCE for conducting the reviews. The Statement of Approach is attached to the Issues Paper at Appendix A or can be downloaded from the Commission's website.

The Statement of Approach noted that an assessment of the effectiveness of competition requires a dynamic analysis over time of the inter-relationship between the structure of the relevant market, the conduct of retailers and customers in the market and the market outcomes that result. The Commission considers that the dynamic interactions between these factors and the resulting impact on the effectiveness of competition can be analysed by considering the following issues:

- the extent to which the market structure and any barriers to entry, expansion or exit limit the ability of retailers to offer competitive products to small customers;
- the extent of independent rivalry between retailers, and in particular the extent and types of marketing to customers;

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<sup>f</sup> The geographic areas served by each gas retailer overlapped, but did not mirror, the geographic distribution areas.

- the ability of customers to make an informed choice and to actively participate in the market;
- the range of price and service offers retailers make available to customers;
- the role and impact that price regulation may be having on customers and on competition in the market; and
- the experience of vulnerable customers in the market and the extent to which the competitive market is enabling these customers to access essential energy services.

The Issues Paper considers these issues in more detail in the context of the Victorian experience and provides a series of specific questions for comment in stakeholder submissions. The feedback the Commission receives in response to the Issues Paper will be an important input into its assessment of the effectiveness of retail competition in Victoria. The Commission will also be engaging consultants to provide expert reports and analysis. It will also be undertaking surveys of small customers and retail energy businesses. The resulting reports will be published on the Commission's website as they come to hand. The Commission encourages stakeholders to provide submissions or input on all of the analysis the Commission undertakes or any other issues that are considered relevant to the analysis.

The timetable for the release the draft and final reports and further information about the consultation process to be followed during the Victorian Review is set out in Chapter 5 of this Issues Paper.

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# 1 Introduction

## 1.1 Purpose of the Issues Paper

The purpose of the Issues Paper is to obtain preliminary feedback from stakeholders and other interested parties about the extent and effect of retail competition in the Victorian gas and electricity markets. In particular, the Australian Energy Market Commission (Commission) wishes to obtain information that will assist it in understanding:

- The changes in the extent of competition that has been experienced since the introduction of full retail competition;
- The current level of competition; and
- The effectiveness of competition that can be expected in the future.

To assist in the preparation of submissions, the Issues Paper sets out specific matters that the Commission is interested to receive comment on. However, it is not the Commission's intention to limit submissions to issues directly raised in this Paper. Accordingly, interested parties are encouraged to raise other issues they consider relevant to the conduct of this review.

## 1.2 Input from stakeholders

Input from stakeholders is vital to enable the Commission to make a robust assessment of the effectiveness of competition in Victoria. In this regard the Commission, in the first instance, is seeking feedback from stakeholders in a general sense regarding the effectiveness of competition in the Victorian retail energy market in providing efficient prices and services to customers. However, in order to fully inform the review the Commission is also seeking detailed responses on a number of issues that the Commission considers are important to address. In particular, the Commission is seeking specific feedback on the following areas:

- Are there obstacles to retailers competing vigorously in the market or is there evidence of more effective competition amongst retailers? For example, are there barriers to entry facing new retailers or for the expansion of market share by new entrants?
- Are customers able to effectively enter market contracts or switch retailer based on an informed choice in the energy retail market or are there obstacles to customers effectively participating in the market? For example, potential delays in switching may be a barrier to participation.
- Are the outcomes in the market in terms of prices and service offerings consistent with what may be expected in an effectively competitive market? For example, are the market contract prices reflective of the efficient cost of supply and are the price and service offerings made to customers consistent with their needs and expectations?

- What role do the safety net arrangements currently play in assisting energy customers and what impact have they had on competitive market outcomes?
- What impact has energy retail competition had on the circumstances and experiences of vulnerable energy consumers and the extent to which the safety net arrangements and the Government's hardship policy has improved circumstances?<sup>1</sup>

The questions above provide a broad framework for the preparation of submissions. In addition, to assist the analysis and consideration by the Commission, a series of "Issues for comment" are provided throughout the Issues Paper. Stakeholders are urged to provide responses to these issues for comment, where relevant. Furthermore, consultant reports related to the review, which are highlighted in Chapter 5, will also be made available for stakeholders to comment on.

In addition, the Commission notes that interested parties may wish to raise other matters that may be relevant to the Victorian Review, for example, the Commission's approach to analysing relevant issues. The Commission encourages interested parties to address these matters in submissions made in response to the Issues Paper.

The Commission intends to publish all submissions on its website. The Commission's approach to confidentiality is set out in Chapter 5 of the Issues Paper and further at 4.4 of the Statement of Approach (Appendix A).

### 1.3 Lodging submissions

The Commission invites written submissions from interested parties in response to the Issues Paper by **5pm, Friday 29 June 2007**. Submissions may be sent electronically or by mail in accordance with the following requirements.

#### Lodging a submission electronically

- The submission must be sent by email to [submissions@aemc.gov.au](mailto:submissions@aemc.gov.au);
- The email must contain the phrase "Retail Competition Review - Response to Issues Paper" in the subject line or heading;
- The submission must be on letterhead (if submitted on behalf of an organisation), signed and dated;
- The submission must be in PDF format;
- The submission must also be forwarded to the AEMC via ordinary mail.

Upon receipt of the electronic version of the submission, the AEMC will issue a confirmation email. If this confirmation email is not received within 3 business days,

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<sup>1</sup> See Chapter 4 for a more detailed discussion of vulnerable customers and the Victorian Government's hardship policy.

it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

#### Lodging a submission by mail

- The submission must be on letterhead (if an organisation), signed and dated by the respondent;
- The submission should be sent by ordinary mail to:  
  
Australian Energy Market Commission  
PO Box H166  
Australia Square NSW 1215
- The envelope must be clearly marked "Retail Competition Review – Response to Issues Paper".

Except in circumstances where the submission has been submitted electronically, upon receipt of the hardcopy submission the AEMC will issue a confirmation letter. If this confirmation letter is not received within 3 business days, it is the submitter's responsibility to ensure successful delivery of the submission has occurred.

It is noted that the Commission is itself subject to important time constraints throughout the Victorian Review.<sup>2</sup> The Commission will have full regard to all submissions lodged within the specified time period but regrets that it may not be able to afford late submissions the same level of consideration.

## **1.4 Structure of the Issues Paper**

The remainder of the Issues Paper is structured as follows:

- **Chapter 2** sets out the policy and legislative framework for the retail competition reviews, including the high level questions that the Commission is required to address in its advice to the MCE;
- **Chapter 3** provides background information about the Victorian retail market and summarises the results of prior reviews of the effectiveness of retail competition in Victoria;
- **Chapter 4** sets out the specific issues that the Commission invites interested parties to comment on; and
- **Chapter 5** sets out the timetable for the Victorian Review and the process for public consultation, and addresses the Commission's approach to confidentiality.

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<sup>2</sup> The timetable for the Victorian Review can be found in Chapter 5.

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## 2 Framework for the Review

### 2.1 Policy and legislative framework

The Australian Energy Market Agreement (AEMA) requires the Commission to review and publicly report on the effectiveness of retail competition in the energy markets of those jurisdictions participating in the NEM and the NGL for the purpose of retaining, removing or reintroducing retail price regulation (retail competition reviews).<sup>3</sup> On 19 April 2007, the Chair of the MCE wrote to the Commission, confirming that the first jurisdictional energy retail market to be reviewed would be Victoria.

The general framework for the retail competition reviews is set out in clauses 14.10-14.16 of the AEMA (which are reproduced in Appendix B). The AEMA requires that for each retail competition review, the Commission must:<sup>4</sup>

- Assess the effectiveness of competition for the purpose of the retention, removal or reintroduction of retail price controls; and
- Publicly report on its assessments of effective competition and on:
  - Ways to phase out the exercise of retail price regulation if competition is determined to be effective and an appropriate timeframe; or
  - Ways to promote the growth of effective competition for those users or areas of a jurisdiction which do not enjoy effective competition.

The Commission is required to base its assessment of the effectiveness of competition on criteria developed by the MCE in consultation with the AEMC and other interested parties (MCE criteria).<sup>5</sup> The MCE criteria are:

- Independent rivalry within a market;
- Ability of suppliers to enter the market;
- The exercise of market choice by customers;
- Differentiated products and services;
- Prices and profit margins; and
- Customer switching behaviour.

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<sup>3</sup> The Economic Regulation Authority (ERA) of Western Australia is required to undertake the review for its jurisdiction at an appropriate time.

<sup>4</sup> AEMA, clauses 14.11(a) and (c).

<sup>5</sup> AEMA, clause 14.11(a)(i). These criteria were finalised during the 12<sup>th</sup> meeting of the MCE on 27 October 2006, and advised to the Commission by letter dated 17 November 2006. The application of these factors to the Commission's assessment of competition during the retail competition reviews is discussed in the Statement of Approach (Appendix A).

The MCE criteria are set at a high level, giving the Commission sufficient flexibility to determine the method of applying the criteria and to determine the indicators to which it will have regard.

On 25 May 2007, the MCE formally requested that the Commission provide it with advice in accordance with clauses 14.10-14.16 of the AEMA (Request for Advice). Paragraph 6 of the Request for Advice requires the Commission to apply the MCE criteria in assessing the effectiveness of competition in the relevant Victorian gas and electricity markets. The Request for Advice is appended to the Issues Paper at Appendix C or can be downloaded from the Commission's website.

The Request for Advice also requires the Commission to use the methodology and approach set out in Parts 2 and 3 of the Statement of Approach (Appendix A). The Commission provided the Statement of Approach to the MCE on 19 April 2007 which sets out the Commission's proposed approach to conducting the reviews, including the method of applying the MCE criteria and the Commission's consultation process.

It is appropriate to draw attention to two issues that are addressed in the Request for Advice. The first relates to the expression "retail price regulation". While the AEMA and other documents relevant to the retail competition reviews adopt this expression, the Request for Advice notes (at footnote 1) that Victorian retail energy prices have not been regulated since 2002. Rather, the Government's oversight of the retail gas and electricity prices comprises a sequence of six average annual adjustments agreed with host retailers for their household and small business customers, the last four years of which were the subject of a negotiated retail price path arrangement. The regulatory framework currently in place in Victoria is discussed in further detail in Chapter 3 of this Issues Paper. The second issue relates to references to a "market" or "markets". The Request for Advice acknowledges (in footnote 2) that there may be more than one relevant market in Victoria for the retail supply of electricity and gas, including a market defined by reference to a group of users or regions within Victoria. Accordingly, references to single or multiple markets in this Issues Paper should not be considered determinative of the Commission's views on market definition.

## **2.2 Matters to be addressed in advice to the MCE**

In providing its advice to the MCE, the Commission is required to address four key questions. These questions, which substantially reflect the obligations contained in the AEMA and the Request for Advice, are:

- Is competition in the retail natural gas market in Victoria effective?
- Is competition in the retail electricity market in Victoria effective?
- For the market(s) where competition is found to be effective, how could retail price regulation be phased out?
- For the market(s) where competition is found to not be effective, how can competition be promoted for those users or areas of a jurisdiction which do not enjoy effective competition?

As noted in Chapter 1, the Commission encourages stakeholders and interested parties to respond to these questions.

The next Chapter of the Issues Paper provides a high level background of the Victorian retail gas and electricity markets and the regulatory arrangements that apply to them, and the previous experience of competition in those markets.

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### **3 Background to Energy Retailing in Victoria**

Since the commencement of reforms in the energy industry there has been an increased focus on ensuring that, where appropriate, competition is used to facilitate improvements to economic welfare and resource allocation. Unlike energy network infrastructure, the energy retail function was seen as a key area where competition, rather than regulation, could provide benefits to the economy. In the retail sector, competition has been largely focused on benefiting end-use customers through more cost-reflective prices, improved product and service quality, and innovation.

Where competition is effective, rivalry between businesses imposes constraints on their pricing and output decisions. Increased rivalry between suppliers in turn improves economic efficiency and outcomes for customers as competing firms seek profitable business and customers exercise choice as they seek the best available offers. In order to attract customers and maintain profitability, businesses are forced to adopt cost reflective prices and introduce a variety of product and service offerings that respond to consumer preferences.

Economic efficiency and consumer welfare is normally promoted by effectively competitive markets and regulatory intervention is unlikely to be warranted in this circumstance. In conducting the retail competition reviews, the Commission is required to determine whether competition in the retail markets for electricity and gas is effective and is delivering these benefits to energy consumers and the wider community such that retail price controls can be removed.

The remainder of this Chapter provides an overview of the regulatory and policy background to the introduction of retail competition in Victoria and the existing regulatory arrangements as they apply to retail energy prices. This Chapter also identifies the key findings of earlier reviews by the Essential Services Commission (ESC), the jurisdictional regulator of essential services in Victoria, of the status of competition in the Victorian retail energy markets.

#### **3.1 Full retail competition and the “safety net”**

In the early 1990s the Victorian Government commenced a process of corporatisation and privatisation of government-owned energy assets and businesses. Following a multi-staged restructuring process, the Government established a number of corporatised retail businesses. For electricity, the retail businesses were initially integrated with the distribution network businesses serving the same areas, while in gas, the retail businesses were established as separate corporate entities but stapled to the distribution business. The geographic areas served by each gas retailer overlapped but did not mirror, the geographic distribution areas.<sup>5</sup>

Prior to privatisation, each retail business was licensed to supply gas or electricity (as appropriate) to a geographically defined customer base, rendering them the “host retailer” for that energy source for that region. Initially, Victoria was serviced by five

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<sup>5</sup> The privatised retail businesses were subsequently separated from the network businesses.

electricity host retailers and three for gas. Each retailer operated as the franchised monopoly retailer in its prescribed area.

Retail competition in both the gas and electricity sectors has been progressively introduced. At the introduction of competition in Victoria only the largest industrial and commercial energy users could make a competitive choice. Over time the ability to choose an energy retailer has been progressively extended to more customers based on the size of their energy use. Full retail contestability (FRC), whereby even the smallest customers can choose their retailer, was introduced for electricity on 13 January 2002, and for gas on 26 October 2002 in conjunction with a safety net for these customers. Table 3.1 below describes the staged introduction of retail competition into Victoria.

**Table 3.1: Timetable for introduction of FRC in Victoria**

Date of eligibility	Threshold customer load	Estimated number of eligible customers
<b>Electricity</b>		
December 1994	In excess of 5 MW (demand)	47
July 1995	In excess of 1 MW (demand)	330
July 1996	In excess of 750 MWh per annum	1500
July 1998	In excess of 160 MWh per annum	5000
January 2001	In excess of 40 MWh per annum	35000
January 2002	All remaining customers	2.1 million
<b>Gas</b>		
1 October 1999	In excess of 500 TJ per annum	35
1 March 2000	In excess of 100 TJ per annum	110
1 September 2000	In excess of 10 TJ per annum	600
1 September 2001	In excess of 5 TJ per annum	600
1 October 2002	All remaining customers	1.4 million

Data source: ESC, *Review of the Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity – Background Report*, 22 June 2004, p. 10.

Prior to the introduction of competition and choice for the smallest energy customers, the Victorian Government expressed the view that “the protection afforded by the competitive market may not be adequate for the last group of franchise customers including domestic and small business customers”.<sup>6</sup> The Government therefore proposed that it would retain a reserve power to regulate retail prices for these customers (called prescribed customers) as a transitional measure until an effectively competitive retail market had developed.<sup>7</sup> The reserve power is contained in section 21 of the *Gas Industry Act 2001* and section 13 of the *Electricity Industry Act 2000*.

The Government has not exercised its reserve power to regulate retail energy prices since 2002. However, against the background of the reserve power it has negotiated a retail price path with the host electricity and gas retailers which applies for a four

<sup>6</sup> Parliamentary Counsel, Hansard, Legislative Assembly, 4 May 2000, p. 1317.

<sup>7</sup> *Id.*

year period ending 31 December 2007. The price path provides for agreed annual movements in average prices for services to prescribed gas and electricity customers. The price path forms part of what is commonly referred to as the “consumer safety net arrangements”.

The consumer safety net arrangements apply to those customers who use less than 5TJ of gas or less than 160MWh of electricity per annum, and who are not taking supply under a market offer from any retailer. The key elements of the arrangements are:

- The host retailer must offer to supply and sell gas or electricity to customers in its previously franchised area at a standard price and on standard terms and conditions. These offers are called “standing offer contracts”, and include supply contracts that are deemed to exist under section 44 of the *Gas Industry Act 2001* and section 37 of the *Electricity Industry Act 2000*;
- The standard offer must include standard terms and conditions relating to minimum retail service standard, customer rights and entitlements, market conduct and information privacy obligations. The standard offer must also comply with the requirements under the Energy Retail Code;
- Host retailers are required to publish their standing offer tariffs in the Victorian Government Gazette. The Government may exercise its reserve power to amend these published tariffs if it considers that the tariffs are unreasonable; and
- A customer who accepts a competitive market contract may subsequently revert to the standing offer.

### **3.2 Victoria’s retail competition experience**

Although the initial restructurings and privatisation of Victoria’s electricity industry created five electricity host retailers, following a series of acquisitions only three host retailers remain: TRUenergy, AGL Energy and Origin Energy. These companies are also the host retailers in the gas industry. Under the consumer safety net arrangements outlined above, TRUenergy, AGL and Origin Energy are each required to offer standing offer contracts to customers within their previously franchised areas. Customers are therefore able to choose between remaining on the standing offer price and contract arrangements or moving to a market contract.

The introduction of FRC has encouraged new entrant retailers to offer to supply gas or electricity in competition with the incumbent retailers. In January 2002, at the introduction of FRC for electricity in Victoria there were 18 retailers that held retail licenses in the state.<sup>8</sup> Following a period of consolidation after the introduction of FRC for gas in October 2002, eight retailers were licensed to retail gas.<sup>9</sup>

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<sup>8</sup> Essential Services Commission, *Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity – Background Report*, 2004, p. 23.

<sup>9</sup> *Ibid.*, p. 24.

Since the introduction of FRC, the ESC has undertaken two reviews of the effectiveness of retail competition. The first review, conducted in 2002, was limited to electricity (2002 Review). The second review, conducted in 2004, examined retail competition for both electricity and gas (2004 Review).

In its 2002 Review, the ESC concluded that competition was not yet consistent with that expected from an effectively competitive market.<sup>10</sup> In particular, the ESC considered that the effectiveness of competition was being affected by structural impediments<sup>11</sup>, a weakness in the availability of customer information and only modest price savings and product and service differentiation.<sup>12</sup> The ESC did find, however, that the pre-conditions for a competitive market, in terms of market structure and conduct, were in place and the outlook for an effectively competitive market was positive. At the time of the 2002 Review, the ESC found that around 3 per cent of customers had switched retailer, while 2 per cent of customers had accepted a market offer from their existing retailer.<sup>13</sup>

In its 2004 Review, the ESC found that competition for the retail supply of gas and electricity in Victoria was generally effective in those groups within the market where sufficient profit margin existed or had emerged. These profitable sub-markets accounted for almost 40% of customers (based on customer numbers), and typically encompassed customers who consumed more than 50 GJ of gas or 6MWh of electricity per annum, operated dual fuel accounts, and were located in metropolitan and large regional centres.<sup>14</sup>

The ESC concluded that retail energy competition was likely to become effective for a much larger proportion of small energy customers in the coming years. More specifically, the ESC was of the view that competition was sufficient, or would soon be sufficient, in the majority of cases to discipline attempts to exercise market power.<sup>15</sup>

In the 2004 Review, the ESC recommended that the consumer safety net be continued subject to a number of proposed amendments. The ESC considered that, given the essential nature of energy services, the extension would safeguard the interests of small energy customers and, in particular, protect the interests of more vulnerable energy customers in the energy retail market.<sup>16</sup> Based on the ESC's findings regarding the effectiveness of competition and on the case for continuing an appropriate safety net, the Government passed legislation in 2004 that retained the safety net framework for a further three years by amending the date on which the

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<sup>10</sup> Essential Services Commission, *Review of the Effectiveness of Full Retail Competition for Electricity – Final Report*, September 2002, p. 79.

<sup>11</sup> According to the ESC, these structural impediments included scale and scope economies and the competitive advantage of incumbency.

<sup>12</sup> Essential Services Commission, *Review of the Effectiveness of Full Retail Competition for Electricity – Final Report*, September 2002, p. 79.

<sup>13</sup> *Id.*

<sup>14</sup> Essential Services Commission, *Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity – Overview Report*, 22 June 2004, p. 3.

<sup>15</sup> *Ibid.*, p. 4

<sup>16</sup> *Ibid.*, p. 7.

reserve power ceases to operate, i.e., 31 December 2007.<sup>17</sup> <sup>18</sup> At this stage, it is unclear whether the Victorian Government intends to take further legislative action on the safety net arrangements prior to its current expiration date.

In the context of the Commission's task, as defined by the MCE and the approach articulated in the Statement of Approach, work that the ESC has completed to date will be relevant to the Victorian Review. While the Commission will gather its own data and evidence in order to make an assessment of the effectiveness of competition, it will have regard to the ESC's findings where they provide an indication of trends and the development of competition in the market.

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<sup>17</sup> *Energy Legislation (Amendment) Act 2004* (Vic).

<sup>18</sup> While the Government accepted the ESC's recommendation that there was a need for the continuation of some form of safety-net arrangement for small energy customers the details of those arrangements varied in some respects from those recommended by the ESC.

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## 4 Issues for Consultation

As outlined in the Commission's Statement of Approach (Appendix A), an assessment of the effectiveness of competition requires a dynamic analysis of the inter-relationship between the relevant market, its structure and the conduct and performance of market participants. Such an assessment requires an analysis of the trends over time of the structure of the market, the interaction and behaviour of the buyers and sellers in the market and the market outcomes. The Commission considers that these interactions, and the resulting impact on the effectiveness of competition can be analysed by considering the following issues:

- the structure of the market and conditions of entry, expansion and exit, such as barriers to entry, and the extent these limit the ability of new entrants to offer competitive products to customers;
- the extent of independent rivalry between firms, in particular the extent and types of marketing to end-use customers;
- the ability of customers to make an informed choice and to actively participate in the market;
- the range of service and price offerings retailers make available to customers;
- the role and impact of price regulation; and
- the experience of vulnerable customers in the market.

This Chapter examines these issues in more detail and identifies specific questions that interested stakeholders are invited to respond to. The Commission considers that factual material provided in response to these questions will assist it in forming a view about the effectiveness of energy retail competition in Victoria.

### 4.1 Market structure and conditions of entry, exit and expansion

The structure of a market and the presence or absence of barriers to entry, exit and expansion can have an important effect on the extent and effectiveness of competition in that or a related market, such as the upstream market. As noted above, the Commission will consider changes in these characteristics over time, as well as changes in the behaviour of sellers and buyers in the market.

As indicated in Chapter 2, there have been significant structural changes to the Victorian retail market since the introduction of FRC. Corporate restructuring resulted in the separation of incumbent retailers from their related or stapled network businesses. More recently, and chiefly in the electricity industry, incumbent retailers have consolidated their positions through a series of mergers and acquisitions. A trend is also emerging of retailers vertically integrating with generation businesses. At the same time there has been significant new entry and evidence of competitive behaviour by smaller independent retailers and by retailers who are incumbents in other jurisdictions.

Entry into a market by a potential new entrant may be constrained by the existence of barriers to entry. A barrier to entry refers to any characteristic of a particular market that places an efficient potential new entrant business at a disadvantage relative to an incumbent business. It is important to note that a barrier to entry does not properly include a cost or other impediment that applies more or less equally to any party wanting to participate in the retail market, irrespective of whether it is an incumbent or new entrant. An important task for the Commission during the Victorian Review will be to ascertain what matters are properly barriers to entry and, where they exist, the effect they have on the effectiveness of competition.

While low barriers to entry and the threat of new entry can expose incumbent retailers to competitive pressure and modify their market conduct, this alone may not be sufficient to constrain the incumbents' pricing and output decisions. For potential, or actual, new entry to effectively serve as a constraint, it must place real pressure on the profits of incumbents, in this case, profits from their retailing function<sup>19</sup> In other words, a new entrant whose product offerings target niche segments of the market may not necessarily have an impact on the price and service outcomes of the incumbent retailers.

Barriers to expansion are also important in considering whether retailing businesses are subject to competitive pressure. A retailer may be able to easily enter a market and set up business, however, there may be limitations on its ability to expand in that market. For energy retailing, this may be due to factors such as an inability to access contracts for wholesale energy to effectively manage risk.<sup>20</sup> Where this is the case, the behaviour of incumbent retailers may be less constrained. However, as noted above, it may also be the case that incumbent retailers are subject to such market requirements but are able to handle them more efficiently.

As noted in Chapter 2, at the commencement of retail competition the Victorian retail gas and electricity markets were each characterised by a limited number of licensed suppliers servicing customers in specified geographic regions. When such markets are opened to competitive entry, the incumbent business may experience certain advantages that may amount to a barrier to entry. For example, the incumbent business is likely to have an established customer base, superior positive brand recognition, and an established reputation. Drawing on stakeholder submissions, the ESC's 2004 Review identified potential barriers to entry to the electricity and gas markets, including:<sup>21</sup>

- incumbent retailer advantages such as customer share and customer details information (to the extent this could be utilised by incumbent retailers);
- access to wholesale energy supply and related risk management products;
- the development costs imposed by regulation;

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<sup>19</sup> Australian Competition and Consumer Commission, *Merger Guidelines*, 1999, p. 50.

<sup>20</sup> However, upstream producers are likely to have an incentive to encourage the expansion of new entrant retailers as this increases the competition for the sale of wholesale energy.

<sup>21</sup> Essential Services Commission, *Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity – Background Report*, 22 June 2004, pp. 30-40.

- business to business systems and processes; and
- inter-jurisdictional ownership and governance arrangements.

Victoria has experienced significant new entry into its retail energy markets. However, if the customer base is closely held by a small number of retailers, there may remain scope for inefficient outcomes. In 2004, the ESC found that for electricity, the host retailers supplied 97 per cent of the total number of customers, while, for gas, each of the three host retailers together held approximately 30-35 per cent of the small customer market.<sup>22</sup>

While vigorous competition can occur within relatively concentrated markets, new entrants eroding the market share of the incumbent retailers can provide a number of benefits. For example, it can provide an incentive for larger retailers to compete more energetically in order to maintain their customer base. This may become necessary for larger retailers in order to preserve their profitability and to ensure that they can underwrite their contract positions in the face of higher levels of customer churn.

While recognising that the concentration of market share and the effectiveness of competition are not necessarily correlated, the Commission will investigate and consider the extent to which market concentration and relative market shares are influencing the behaviour of retailers within the market and the choice available to customers. The Commission will also seek information and evidence regarding whether barriers to entry, exit and/or expansion are sufficiently low that retailers entering the market are able to constrain the behaviour of incumbent retailers and offer genuine alternatives for customers for the core retailing service.

#### **Issues for comment**

For each of the gas and electricity retail markets:

1. Are the structural conditions sufficient to support an effectively competitive market?
2. Is there any evidence that incumbent retailers are not constrained by participants?
3. Are there barriers to entry that impact on effective competition?
4. Are there barriers to expansion or exit that impact on effective competition?
5. Are the barriers such that retailers are not influenced by the threat of new entry?

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<sup>22</sup> *Ibid.*, p. 24.

## 4.2 Independent rivalry and the behaviour of retailers

An indication of the extent to which a market can be characterised as effectively competitive can be obtained by examining the behaviour of the retailers. Within a single market, behaviours may range from indifference to competition, through to pro-active strategies to compete for customers. For example, in 2004 the ESC found that marketing strategies ranged from customer retention strategies where a retailer had previously established a strong position in the market, through to acquisition strategies focused on attracting higher volume consumption customers currently with a competing retailer.<sup>23</sup> Further, the ESC found that retailers increased marketing to their own customers following heavy marketing from competitors.<sup>24</sup>

While market structure and entry conditions can have an important influence on the extent of competition in a market, rivalrous conduct can be observed between sellers in relatively concentrated markets. In an effectively competitive market, it is expected that retailers would continue to adopt pro-active marketing approaches in presenting their price, service and product offerings to existing and prospective customers.

An important manifestation of independent rivalry between businesses is price-based competition. Vigorous competition around price can be expected to result in prices converging towards the efficient long term cost of supply. Competition between retailers can also be observed through improvements and innovations in customer service and product innovation. The likely outcomes of price-based and service-based competition are discussed in further detail at section 4.4 below.

Strong competition between retailers around price, service and product offerings is to be encouraged. However, conduct that distorts effective consumer choice or otherwise interferes with customers' decision making processes undermines effective competition and is likely to result in inefficient outcomes and reduce consumer welfare. For example misleading or coercive marketing can result in customers making choices that do not produce the outcomes and value they have paid for.

The ESC's 2004 Review of competition in Victoria's retail gas and electricity markets found that active and expanding rivalry among retailers has taken place without evidence of systemic misleading or anti-competitive market conduct.

The marketing and business strategies adopted by retailers to increase customer numbers and consumption volumes, and to improve profitability are important indicators for this review. The Commission is interested in understanding the kinds of strategies that are being employed, their objectives and outcomes. In the case of marketing and other strategies, the Commission also seeks information about the audiences being targeted by those strategies and their impacts.

Noting the capacity for retailer behaviours and their price and service outcomes to affect market efficiency and the welfare of consumers, the Commission is seeking

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<sup>23</sup> *Ibid.*, p. 58.

<sup>24</sup> *Id.*

evidence of the existence (or absence) of rivalrous conduct between retailers and, whether its market outcomes are consistent with effective competition.

#### **Issues for comment**

For each of the gas and electricity retail markets:

6. What does the level and extent of marketing indicate about the level of competition?
7. What do the types of marketing indicate about the level of competition?
8. Is there evidence of anti-competitive or misleading marketing activity?

### **4.3 Customer choice and behaviour**

Behaviour on the demand-side of the market as well as the conduct of suppliers must be considered in an assessment of the effectiveness of competition. In making their electricity and gas supply decisions in an effectively competitive market, customers should be able to freely, and easily, exercise informed choices amongst a number of competing suppliers providing alternative price/service offerings.

A number of pre-conditions are necessary in order for customers to be able to effectively exercise choice in the market. These include, but are not limited to:

- An awareness of competition between retailers and the availability of customer choice of retailers;
- Easily obtainable and comparable information about retailers and their supply offers; and
- The ability to effectively exercise their choice.

Customer awareness is the first essential component for effective customer participation in a competitive market. In order for customers to participate in a market they must first be aware that they have a choice of retailer and be able to identify alternate suppliers. Without this knowledge customers will not take steps to investigate whether alternative or better offers exist for the supply of their electricity and gas.

Access to information that allows customers to effectively compare the price and non-price aspects of alternative offers is also necessary to facilitate the effective participation of household and small business customers in the competitive market. Consumer welfare can be enhanced when customers have accurate information about the products and services being offered by retailers. However, it is not the volume of information that enables customers to make an effective choice. Rather, the information must be relevant, understandable, usable, comparable and easy to access at a low cost.

A competitive market should provide incentives for retailers to provide effective information to customers in order to allow them to identify efficient and reliable retailers as well as offers that are superior. Therefore, the Commission is interested in the extent to which customers are able to obtain information that facilitates an effective choice. It will also be relevant to understand the extent to which customers are able to evaluate the information made available to them and reach informed choices on the basis of that information.

**Box 4.1: Customer awareness and behaviour identified in the 2004 Review**

In 2004, the ESC found:

- the majority of Victorian customers were aware that they are able to choose their electricity or gas retailer, although a large percentage of customers did have difficulty in identifying alternative competing retailers;
- customer confidence in their ability to obtain information had fallen since the 2002 review. Approximately half of the customers surveyed by the ESC cited a lack of information as the basis for their lack of confidence;
- Despite these concerns, there was a consistently high level of switching activity in both electricity and gas retail markets. As at the end of April 2004, around 13 per cent for electricity and 12 per cent of gas customers were no longer with their host retailer.

Where customers can access all the necessary information, the available market offers need to be sufficiently attractive such that there is an incentive to switch retailers. The Commission wishes to understand what motivates customers to switch. For instance, even where the price offered by two competing retailers is identical customers may still choose to switch because of factors such as the perceived benefits of improved service or a brand preference.

Where customers are aware of competition and are able to make an informed choice about which offer is best for them, there must also be appropriate processes in place for the customer to give effect to that choice. The absence or ineffectiveness of retailing processes may operate as a barrier to a customer switching retailer. For example, complex contracting and information requirements that must be met in order to switch retailer or unreasonable delays in effecting the switch are likely to influence customers' decisions, and may discourage customers from participating in the competitive market altogether.

The Commission also wishes to understand whether customers of all types have similar levels of access to the competitive market. For instance, the size of consumption or the manner in which energy is used (such as peak or off-peak) may mean that some customers are more attractive to a retailer than others and are therefore pursued more actively through retailer marketing efforts. The Commission will be seeking information regarding whether customers in different locations or having different consumption characteristics are receiving market offers and whether there are systematic differences in the offers they receive.

### **Issues for comment**

For each of the gas and electricity retail markets:

9. What evidence is there of customers seeking or obtaining market offers?
10. Are customers switching retailers to take advantage of competitive market offers?
11. Is there sufficient awareness about the existence of competition and market offers?
12. Are customers able to effectively evaluate and search for market offer information such that they can make an informed choice?
13. Are there differences in customer choice and participation across customer groups?
14. What motivates a customer to switch retailer?
15. Does the option of receiving dual fuel supply from a retailer influence customer choice?
16. Are there any barriers to a customer switching?
17. What impact do non-price offers have on customer behaviour?
18. What is the relationship between customer switching and marketing activity?

#### **4.4 Price and service quality outcomes for customers**

Where there is independent rivalry and customer choice, retailers will be constrained in their price and output decisions by the market activity and competitive responses of other market participants. In a competitive market, businesses that do not offer attractive prices or services that reflect the needs of customers may lose market share and experience a corresponding reduction in profitability. Effective competition of this kind drives prices towards the efficient costs of supply (including a competitive profit margin) and results in a range of products and services that more closely reflect the preferences of customers.

Where competition is not effective retailers will not be subject to sufficient pressure to maintain prices at efficient levels or to offer customers the services they prefer. In this situation, retailers may be in a position to exercise market power such that they can earn margins above the efficient long run costs of supply. These outcomes can distort consumption decisions and efficient resource allocation and result in a loss of social welfare. In these circumstances, adopting measures to remove obstacles to entry and competition as well as enforcing competition laws may be appropriate. During the transition to effective energy competition, governments have also intervened directly by regulating retail prices to prevent inappropriate pricing and achieve better price outcomes for customers.

Therefore, indicators of the outcomes being delivered in the market, including the price of offerings and their cost-relativeness, the extent of differentiated products and services on offer, and the profits available in the market to retailers, can provide a further indication of the extent of effective competition.

The ESC's 2004 Review of competition found that although market offers were being made available to all small energy users, the margin analysis undertaken indicated that the market contract offers made to customers consuming less than 6MWh of electricity and 50GJ of gas per annum were generally unattractive compared to the standing offer prices. The ESC also found that those customers who predominately use energy during off-peak periods were, at the time of the review, generally unprofitable to serve at market contract prices compared to the standing offer. However, the ESC was of the view that prospective changes in the standing offer tariffs were likely to increase the attractiveness of market prices relative to standing offer prices and therefore improve the rate of customer acceptance of market contracts.<sup>25</sup>

The ESC also found that non-price elements were increasingly used by retailers in market offers, and were often ranked highly by residential and small business customers as a reason for entering into a market contract. The ESC stated:<sup>26</sup>

“Customers remain focussed upon price as their key motivator to enter a market contract, although they recognise the growing variety and innovation in offers. The ability to bring gas and electricity together remains attractive to customers, and retailers expect non-price differentiation of offers to become more attractive.”

Overall, the ESC considered competition in the Victorian energy market to be generally effective in constraining prices and delivering non-price benefits.<sup>27</sup>

The Commission intends to analyse indicators of the market outcomes delivered by the competitive, energy retail market in Victoria building upon the ESC's 2004 Review. Accordingly, it is seeking comments, information, and where possible, data on the extent to which the competitive market has been providing prices that are reflective of long run supply costs and services that are efficient and that customers desire. In this context, the Commission is interested in obtaining information about the market contract prices that are being accepted by customers and their relationship to standing offer prices.

In addition to price offers, the Commission is seeking to identify the non-price elements that retailers offer or provide in order to attract or retain customers. Non-price elements can either relate to value added services, inducements such as DVD players, or perceptions of service quality differences between retailers.

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<sup>25</sup> *Ibid*, pp. 90-91.

<sup>26</sup> *Id.*

<sup>27</sup> Essential Services Commission, *Review of Effectiveness of Retail Competition and Consumer Safety Net in Gas and Electricity – Overview Report*, 22 June 2004, p. 3.

## Issues for comment

For each of the gas and electricity retail markets:

19. What evidence is there of price competition, for example, are prices reflective of the efficient long run costs of supply?
20. What types of competitive offerings are being made available to customers, and is there evidence of new types of offers being made to customers over a range of customer classes?
21. Do retailers clearly and accurately communicate information to customers about their market offers?

## 4.5 The role and impact of retail price regulation

One of the matters raised in submissions during the public consultation on the draft Statement of Approach<sup>28</sup> was the effects that existing price oversight arrangements have had on the development of competition in the Victorian retail energy markets. In order to analyse the effectiveness of competition and the need – if any – for retail price regulation going forward, the Commission intends to analyse the role that price regulation has played in the market both in transitioning consumers through the initial phase of retail competition and in either facilitating or impeding the early development of competition. It will also examine the impact it may have on the delivery of efficient market outcomes.

The existing regulatory scheme that applies in Victoria – the consumer safety net arrangements – is summarised in Chapter 3 of this Issues Paper. Under those arrangements, each host retailer in Victoria is required to make a standing offer to every eligible customer in its previously franchised area. This ensures that all customers below the consumption threshold<sup>29</sup> have access to electricity and gas supply on a standard tariff and in accordance with minimum terms and conditions. The safety net permits all Victorian energy customers to choose between a standing offer tariff and contract terms (a standing offer), and a market contract price and terms, which must also include the required minimum terms (a market offer). While a customer who has accepted a market offer can revert to a standing offer, the standing offer is intended to operate as a safety net rather than the default contracting position.

It is important to note that the standing offer does not cap the offer price. That is, a retailer is free to offer, and a customer is free to accept, offers that are above the standing offer tariff. An example of where this may commonly occur is for customers seeking green energy or other value added services. As noted above, both

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<sup>28</sup> See, for example, submissions from the Energy Retailers Association of Australia (at p. 1), Origin Energy (at pp. 12-13) and TRUenergy (at pp. 1-2).

<sup>29</sup> To be eligible for the consumer safety net arrangements, a customer's consumption must be less than 160MWh of electricity or 5TJ of gas per annum.

the standing offer and the market offer are required to include certain minimum terms and conditions, for example, in relation to disconnection. The Commission is interested in obtaining views on the effectiveness of the Victorian safety net arrangements in protecting the interests of consumers and the impact it has had on competition and the exercise of consumer choice.

While the safety net tariff served as a transitional safeguard for customers during the initial period of FRC, it is now necessary to consider whether these arrangements have impeded the development of competition or whether they may do so in the future. The Government's intention to avoid that outcome was expressed in the following terms at the time the proposed reserve power was being debated:<sup>30</sup>

"It is not the intention that the government will try to second-guess a competitive market. Nor is it the intention that the reserve power will be used to prevent or inhibit the development of competition. For that reason, the government is not seeking to regulate retail electricity prices where competition has developed or might reasonably be expected to develop."

It is possible, however, that the consumer safety net arrangements may inhibit or prevent the further development of competition to the extent that the agreed price path is set at a level that provides insufficient margin for new entrant retailers or to profitably supply some classes of customer. Competition may also be impeded where the retailers perceive the "price to beat" as being the tariff determined in accordance with the price path, rather than pricing according to the long run cost of supply or the lowest priced tariff offered by a competitor. The Commission, therefore, wishes to investigate what impact retail price regulation in Victoria has had or is having on competitive outcomes.

#### **Issues for comment**

For each of the gas and electricity retail markets:

22. Have the consumer safety net arrangements been effective in ensuring access to supply in Victoria?
23. What are the benefits of the consumer safety net arrangements?
24. What are the detriments of the consumer safety net arrangements?
25. Have the consumer safety net arrangements had any unforeseen or unintended impacts on the development of competition?
26. Other than price, are there differences between the standing offers and the market offers that may impact on the effectiveness of competition?

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<sup>30</sup> Parliamentary Counsel, Hansard, Legislative Assembly, 4 May 2000, p. 1317.

## 4.6 Impact of competition on vulnerable customers

In assessing whether competition is effective and, going forward, whether price regulation should be phased out of the Victorian retail energy markets, it will be important to consider the circumstances of vulnerable energy market customers who, due to their individual circumstances, may be less able to effectively participate in the market. This requires consideration to be given to how vulnerable customers can be identified, how vulnerability arises and the existing measures in place to address it.

While a majority of customers are likely to have similar experiences regarding the level of competition in the market and the ability to exercise choice, there may be certain customers that, due to their individual circumstances, are not able to effectively participate in the competitive market. Often these customers are not able to effectively participate due to economic, social or personal circumstances that impact on their ability to make informed choices or to attract affordable market offers from retailers. The Commission wishes to understand how these factors affect customer vulnerability and whether the effects are exacerbated or mitigated by the introduction of competition.

The Commission recognises that energy services are essential for all members of the community. It will therefore be necessary to establish whether certain vulnerable customers are being precluded or impeded from actively participating in the competitive energy market or from otherwise obtaining affordable energy services on reasonable terms and conditions. The Victorian Government has sought to address issues related to customer vulnerability through its energy consumer hardship policy and energy retailers have also introduced policies to better manage issues arising from customer vulnerability. The Commission is seeking information and comments on the effectiveness of those arrangements in dealing with vulnerable energy customers.

In 2006, the Victorian Government issued a statement in which it said that the role of its hardship policy is:<sup>31</sup>

“..firstly, to work with key stakeholders involved in the retailing of energy services; secondly, to provide both financial and non-financial support to energy consumers in genuine and severe financial difficulty; and thirdly, to provide legislation that creates certainty for energy retailers, so an environment of affordable access to energy services and fair commercial viability for all market participants exists.”

Programs to support Victorian customers facing hardship include:

- Requiring retailers to have in place clearly articulated hardship policies approved by the ESC;

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<sup>31</sup> Department of Infrastructure, *Government Energy Consumer Hardship Policy Statement*, available at [http://www.dpi.vic.gov.au/dpi/dpinenergy.nsf/9e58661e880ba9e44a256c640023eb2e/eab4271e53d31fa3ca2572dc0002e2af/\\$FILE/Hardship\\_Policy\\_Statement.pdf](http://www.dpi.vic.gov.au/dpi/dpinenergy.nsf/9e58661e880ba9e44a256c640023eb2e/eab4271e53d31fa3ca2572dc0002e2af/$FILE/Hardship_Policy_Statement.pdf)

- Preventing customers participating in a retailers hardship program from being disconnected;
- Providing energy concessions and relief grants; and
- Providing access to financial counselling services.

Noting the issues faced by vulnerable customers and the support arrangements currently in place, the Commission wishes to understand the energy-specific and non-energy market causes of customer vulnerability. It also wishes to understand the impact of energy retail competition on the circumstances and experience of vulnerable energy consumers and the extent to which the safety net arrangements and the Government's hardship policy has improved their circumstances.

**Issues for comment**

For each of the gas and electricity retail markets:

27. Which customers are likely to be considered vulnerable customers?
28. What factors contribute to customer vulnerability?
29. Does the structure and operation of market contribute to customer vulnerability?
30. How does a customer's vulnerability affect their participation in the market?
31. How effectively do retailers identify vulnerable customers and assist them?
32. Do the existing regulatory policies facilitate participation in the market for vulnerable customers?
33. Are the existing government and retailer initiatives effective in managing vulnerable customers in a competitive market environment?

## 5 Timetable and consultation

This Chapter identifies the reports and advice that the Commission is required to publish during the Victorian Review and the prospective dates for publication. It also sets out the process for public consultation during the Review, the opportunity for stakeholders to comment on independent reports and research commissioned by the Commission, and the Commission's approach to the treatment of confidential information.

### 5.1 Reports to the MCE

The Request for Advice (at paragraph 10) requires the Commission to provide advice to the MCE using a four stage reporting process. In accordance with paragraph 12, the final report is to be provided by the end of February 2008.

The first report is to be a draft report of the Commission's assessment of the effectiveness of competition in the relevant Victorian retail gas and electricity markets (First Draft Report). The First Draft Report is to invite public comment on its findings.

At the conclusion of the public consultation process, the Commission will consider the submissions made and the results of any other consultation undertaken. It will then publish a final report setting out its assessment of the effectiveness of competition (First Final Report).

The Commission must also publish a draft of its advice to the MCE as to, where competition is found to be effective, ways to phase out retail price regulation, or to promote competition where it is not (Second Draft Report). The Second Draft Report is also to include advice on Victoria's compliance with clauses 14.10-14.14 of the AEMA (Appendix B). The Commission anticipates that the Second Draft Report will be published at the same time as the First Final Report.

Following consultation on the Second Draft Report, the Commission will consider the submissions made and the results of any other consultation undertaken. It will then publish its final advice on the ways to phase out retail price regulation where competition is effective, or to promote competition where it is not (Second Final Report).

Based on the requirement that the Second Final Report be provided by February 2008, the Commission has developed a timetable for the Victorian Review. This timetable is set out in the table below.

<b>Indicative Time</b>	<b>Event</b>
September 2007	First Draft Report
October 2007	Submissions on the First Draft Report due
November 2007	First Final Report

November 2007	Second Draft Report
December 2007	Submissions on the Second Draft Report close
February 2008	Second Final Report

## 5.2 Public consultation

Paragraphs 8 and 9 of the Request for Advice require the Commission to issue a public notice announcing the commencement of the Victorian Review together with a proposed timetable for its completion, including the provision of advice. The notice must also call for public submissions on the effectiveness of competition in the Victorian retail gas and electricity markets.

On 1 June 2007, the Commission published on its website a notice in accordance with the requirements of the Request for Advice. This notice is to be published in *The Australian* and *The Age* newspapers on 2 June 2007.

The Commission has published this Issues Paper calling for submissions on issues relevant to the Victorian Review, including on the effectiveness of competition. Submissions are to be lodged by 5pm, Friday 29 June 2007.

The Request for Advice also requires (at paragraph 9) the Commission to consult with the Victorian Government at each step in the advice process, and consult and meet with relevant stakeholder groups in Victoria who have interest in the oversight, regulation or other control of retail prices. In the lead up to the First Draft Report, the Commission intends to undertake a range of activities to gather quantitative and qualitative data relevant to the Victorian Review. These will include:

- A survey of Victorian domestic and small business consumers;
- A survey of Victorian gas and electricity retailers;
- Issuing a data template to gas and electricity retailers to collect quantitative data;
- Meetings with retail energy businesses and with consumer groups; and
- Reviewing and considering submissions made in response to this Issues Paper.

The Commission will also engage in ongoing consultation with the Victorian Government and the ESC.

## 5.3 Consultants' reports

The Commission has retained consultants to provide expert advice in the context of the Victorian Review. It is the Commission's intention to publish the reports it commissions, insofar as they provide information that is relevant to the Review.

Shortly, the Commission intends to release two reports commissioned from an independent expert economic consultant: one outlining the structure of the upstream

gas market, its competitive environment and potential implications for competition at the retail level, and the other outlining these issues in relation to the wholesale electricity market. As foreshadowed in the preceding Chapters, interested parties are invited to refer to these reports and to provide any relevant observations in relation to their contents. Copies of these reports will be available to download from the “Review of the Effectiveness of Competition in Gas and Electricity Retail Markets” webpage on the Commission’s website.

Prior to the release of the First Draft Report, the Commission also expects to publish the following reports from its consultants:

- The results of a survey of domestic and small business customers, and the non-confidential results of a survey of Victorian energy retail businesses;
- A non-confidential report setting out the economic analysis of prices and profit margins.

Interested stakeholders will also be given the opportunity to comment on these reports.

## **5.4 Confidentiality**

The Commission’s approach to confidentiality is set out in full at 4.4 of the Statement of Approach (Appendix A). However, the Commission wishes to remind parties making submissions on the Issues Paper that information relied upon by the Commission should be published, commented upon and tested in open debate.

The Commission considers that its established practice of omitting confidential or commercially sensitive information contained in a submission prior to publishing the submission on its website offers adequate protection to parties making submissions in response to the Issues Paper. A party who provides information to the Commission and considers that part or all of the information being provided is confidential or commercially sensitive may request that that information be kept confidential. A request to maintain confidentiality should:

- Be made in writing;
- Clearly identify the information which is confidential and, where possible, separate that information from the other non-confidential information in the submission; and
- Set out the basis upon which the information is confidential and/or commercially sensitive, including, for example, a statement as to any detriment that is likely to result to the person or any third party from the disclosure of that information.

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