



28 February 2014

John Pierce  
Chairman  
Australia Energy Market Commission  
PO Box A2449  
SYDNEY SOUTH NSW 1235

Dear Mr Pierce

**AEMC approach paper: 2014 retail competition review**

The Australian Energy Regulator (AER) welcomes the opportunity to provide this submission on the Australian Energy Market Commission's (AEMC) approach paper for the 2014 retail competition review.

The AER concurs with the AEMC's views on the importance of competitive retail markets. We believe that effective retail competition provides strong incentives for suppliers to operate efficiently and be price competitive. This can deliver significant benefits to consumers, both in terms of competitive prices and more innovative products. Given these benefits, it is important that stakeholders are provided with information on the development of the market and the effectiveness of retail competition, such as in the AEMC's retail competition review.

This submission highlights a number of issues we believe are relevant to the AEMC as it undertakes its retail competition reviews. These issues are drawn from the AER's experience in monitoring and reporting on the performance of the retail market, as well as our experience in monitoring the wholesale market.

*Assessment framework*

The AEMC's approach paper outlines five broad competitive market indicators which it will use to assess the effectiveness of competition. These are:

- the level of customer activity in the market
- barriers to retailers entering, expanding or exiting the market

- the degree of independent rivalry, such that retailers are competing strongly with each other to attract and retain customers
- customer satisfaction with market outcomes, and
- retailer outcomes with respect to prices and competitive retail market costs.

The focus on these indicators allows a broad review of the state of retail competition in each jurisdiction. This approach is sensible and broadly consistent with the approach adopted by competition authorities and regulators.

This approach, however, is not without its challenges. It can be difficult to weigh up qualitative measures (such as results of surveys) and quantitative measures (such as market share data) to reach firm conclusions on the overall effectiveness of competition, particularly where there is conflicting data.

We note that the AEMC intends to consult later in the year to refine the approach for future competition reviews. An issue that could be explored in this review is whether more clarity can be provided around the framework for assessing the state of retail competition.

For example, the AEMC notes that its analysis will consider market share and concentration and how these have changed over time. Generally, competition authorities use quantitative measures of market concentration or market power, such as the Herfindahl-Hirschman Index, to identify where there are issues that warrant further examination. It may be worth considering whether measures of market share and concentration should be used as a screen of where there may be competition concerns, rather than more generally as one factor in an overall assessment.

Another issue that could be clarified concerns the term 'effective competition.' In the approach paper, it is noted that while 'one market may be more competitive than another, they may both be considered effectively competitive.' It may assist stakeholders better understand the AEMC's assessment approach if some further guidance was given on the range of market outcomes that are intended to be represented by effective competition, or alternatively a scenario was outlined where competition may be considered less than effective.

#### *Data requirements*

One of the key challenges of this review will be to gather and process the data required to make an assessment of the state of retail market competition.

In particular, we note that the AEMC is intending to measure profit margins as part of its report. While an accurate measure of profit margins would be a major step forward in understanding the dynamics of competition in our retail markets, this work involves significant challenges.

First, the work of assessing retailer revenues and margins will require detailed understanding of retailer costs. This in turn requires wholesale market data and data on network costs.

Second, a robust assessment of profitability will require information that is not publically available, in particular some retail pricing and contract market data. While the AEMC notes that it will require significant amounts of data from retailers, it is not clear what will happen if some of this information is not provided. In these circumstances, reliance on publically available information will make the AEMC's task more manageable, but may mean that the analysis of profitability is not as robust.

These data challenges would appear to make the task of assessing profitability challenging, particularly for the 2014 retail competition review.

*Potential overlap of reporting roles*

As the regulator for retail markets under the National Energy Customer Framework (Customer Framework), the AER is responsible for monitoring and enforcing compliance under the National Energy Retail Law (Retail Law) and reporting on the performance of the retail market and energy businesses.

This reporting includes the requirement under section 284 of the Retail Law to publish an annual retail market performance report. In part this report assesses:

- competition in retail energy markets, by assessing the active retailers, the number of customers of each retailer and switching rates in jurisdictions that have commenced the Customer Framework, and
- energy retailer performance, by assessing retailers' levels of customer service as well as the way in which they assist customers experiencing payment difficulties.<sup>1</sup>

Our reporting work is informed by the significant data that the AER has gathered, particularly from our Energy Made Easy website and through our wholesale and retail market monitoring work.

The AEMC's approach paper suggests that the AEMC will also be reporting on some of these indicators. The AEMC notes that as part of its analysis it will be considering customer churn, market shares and customer satisfaction.

We believe that in areas where the AER already has ongoing reporting responsibilities, significant care needs to be taken to minimise unnecessary duplication of work. We believe that there may be merit in the AEMC relying on the AER's analysis in these areas where we already have reporting responsibility and the data to support this reporting role.

If you have any queries relating to this submission please contact Gavin Fox on 02 6243 1249.

Yours sincerely



Andrew Reeves  
Chairman  
AER

---

<sup>1</sup> Further detail on the material that must be included in our retail market performance reports is outlined in sections 166 and 167 of the National Energy Retail Rules.

